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**IRS BUDGET AND ITS IMPACT ON TAX
SYSTEMS MODERNIZATION AND
MISCELLANEOUS TSM MATTERS**

Y 4.G 74/7: IN 8/58

IRS Budget and its Impact on Tax Sy...

HEARING
BEFORE THE
COMMERCE, CONSUMER, AND MONETARY
AFFAIRS SUBCOMMITTEE
OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
ONE HUNDRED THIRD CONGRESS
SECOND SESSION

MARCH 8, 1994

Printed for the use of the Committee on Government Operations



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IRS BUDGET AND ITS IMPACT ON TAX SYSTEMS MODERNIZATION AND MISCELLANEOUS TSM MATTERS

TUESDAY, MARCH 8, 1994

**HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER, AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
*Washington, DC.***

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2247, Rayburn House Office Building, Hon. John M. Spratt, Jr. (chairman of the subcommittee) presiding.

Present: Representatives John M. Spratt, Jr., Marjorie Margolies-Mezvinsky, Christopher Cox, and Stephen Horn.

Also present: Thomas S. Kahn, chief counsel; Richard W. Peterson, senior counsel; Jacquetta N. Teal, assistant clerk; and Jane Cobb, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN SPRATT

Mr. SPRATT. Good morning. We are happy to welcome back this morning Margaret Richardson, who is the Commissioner of the Internal Revenue Service. We also want to welcome this morning Robert Tobias, who is the president of the National Treasury Employees Union, who will testify following Commissioner Richardson.

Today we turn again to examine the Service's modernization program, but today we particularly focus on efforts to enhance revenue collection and to provide taxpayers with more efficient service. Our subcommittee has taken a longstanding interest in the modernization program, and we have worked closely with the Service in trying to see the modernization program implemented and made effective.

Today we will primarily consider the 1995 budget request regarding modernization, but we especially want to address an issue that is not yet settled in the budget itself, and that is the issue of a compliance initiative, the cost of which has not been included in the budget request sent over by the administration.

In order for this initiative to be approved, it must be counted outside the current discretionary caps which are in force under the various budget acts. Put otherwise, some sort of waiver, through one device or another, will have to be obtained for the initiative to be undertaken.

The Clinton administration supports such an initiative on the grounds that it would generate greater revenue over 5 years than it would cost. In his testimony on February 23 before the Senate Finance Committee, Director of OMB, Leon Panetta, specifically stated and endorsed special budgetary treatment on these grounds. In the budget sent up by the Clinton administration, it was noted that it is essentially asking for the same type of treatment which was given to an IRS compliance initiative in 1990 and 1991 when President Bush was in office.

Helping us to understand this issue, Mr. Tobias will address the ability of the IRS to convert clerical personnel who are being freed up, so to speak, made available as a result of modernization, to convert these skills into more highly skilled employees who can deal with matters such as increased compliance, and employees who can become revenue agents and field auditors.

In addition, with respect to budgetary matters, we will hear about the increase in appropriations for TSM hardware and software. This year's budget provides for an increase of \$681 million to \$989 million, a substantial increase; and we will ask what the effects on acquisition, especially scheduling, are likely to be.

Finally, there are three miscellaneous TSM matters upon which we will hear testimony today: One is the shortfall in telephone accessibility for taxpayers in the 1993 tax season and its implications for more sophisticated applications of telephone systems.

The second is the lack, to date, of an administration program to make needed changes in tax statutes, such as not requiring actual signatures for electronic filings so that TSM can work out more feasibly.

Third, we would like information on what the IRS is doing to address the efforts of individuals who steal money from the government by obtaining IRS refunds that they do not actually deserve. There have been some claims that the broadened use of electronic filing has created new opportunities to undertake such tax fraud.

I will turn to the other members for opening statements, then we will hear from the Commissioner, and then from the president of the National Treasury Employees Union. But first let me turn to Chris Cox, our ranking minority member, for an opening statement on his behalf.

Mr. Cox. I would like to thank the chairman, and then I would like to thank Commissioner Richardson and the balance of our panel for being here today to discuss TSM, at an appropriate juncture, when millions of Americans are busy preparing their tax returns.

I am pleased that the IRS is now going to be joining the technological revolution that the rest of America is also involved with. The multibillion-dollar investment should help speed up the process of return evaluation and refund provision.

I am concerned, as TSM moves forward, that serious continuing problems with taxpayer service be ameliorated rather than exacerbated.

TSM, by itself, doesn't address the fact that many taxpayers struggling through the process can feel that the IRS is much more like the Grim Reaper than Florence Nightingale. We have to ensure that, as a result of this investment, the process is more

human oriented, more service oriented than it has been in the past. There is, of course, a risk that the opposite could occur. So I will look forward to discussing with each of you this morning the manner in which you expect to achieve these results through greater investment in technology.

Thanks very much.

Mr. SPRATT. Thank you, Mr. Cox.

Ms. Margolies-Mezvinsky.

Ms. MARGOLIES-MEZVINSKY. I would just like to welcome the panel. I met with the Commissioner yesterday and was intrigued by what she had to say, and I think all of us will be.

Thank you, Mr. Chairman.

Mr. SPRATT. Thank you.

I would like to, at this point, enter in the record, if there is no objection, a statement by Congressman Gene Green who could not be here today, and also reserve for the record a statement to be submitted by the full committee chairman, John Conyers. If there is no objection, the two items will be placed in the record.

[The prepared statements of Mr. Conyers and Mr. Green follow:]

Statement of John Conyers, Jr.

March 8, 1994 Hearing
The Internal Revenue Service FY 1995 Budget

Committee on Government Operations,
Subcommittee on Commerce, Consumers and Monetary Affairs

Good morning. I want to thank Chairman Spratt for his timely hearing on the IRS 1995 budget. As American taxpayers sit down to prepare their tax returns on kitchen tables across America, they want to be assured that tax collections are as efficient and painless as possible and that all Americans are called on to pay their fair share. If done well, the Tax System Modernization (TSM) program at the Internal Revenue Service will help sooth some of their fears.

In addition to the TSM program, however, I want to raise an issue under the Government Operations Committee's jurisdiction over our nation's budget laws. As Congressman Spratt well knows, the Government Operations Committee has aggressively exercised its jurisdiction over federal budget laws. Congressman Spratt has frequently joined us at the Legislation Subcommittee for various budget process hearings and, today, I am pleased to return the favor.

Last year, on the 100th day of the Clinton presidency, the House adopted enhanced rescission legislation. Subsequently, with Congressman Spratt's energy, the House adopted an entitlement and revenue review mechanism requiring for the first time Presidential and Congressional review of spending for mandatory programs. The Committee also prepared the Deficit Reduction Trust Fund legislation. Last year, both the entitlement review process and the trust fund were enacted by President Clinton as Executive Orders.

The President's FY 1995 budget includes an IRS initiative to increase tax compliance. The multi-year proposal would add 5,000 "full time equivalents" (FTEs) for audits, collections and other tax compliance activities. The proposal is similar to the FY 1991 IRS compliance initiative, adopted by Congress and the Bush Administration in the 1990 Budget Agreement. As was true for the FY 1991 initiative, the discretionary spending cap would be increased by the amount appropriated for the compliance initiative, approximately \$405 million for FY 1995 or \$2.025 billion over five years.

The Administration asserts the increased collections triggered by the proposal would more then compensate for the

initial expenditure. Treasury Department estimates suggest the FY 1991 initiative, on which the current proposal is based, increased revenue collections by \$4.7 billion over five years. When combined with management savings the FY 1991 IRS compliance initiative generated more than \$13 billion in savings.

This budgetary treatment for these IRS compliance activities raises several important questions. What can Congress anticipate, in terms of enhanced collections, decreased tax delinquency rates or increased confidence in our tax system, by pursuing this proposed initiative?

I am pleased Margaret Richardson, the Commissioner of the Internal Revenue Service, and Robert Tobias, President of the National Treasury Employees Union, could join us this morning. The Committee will certainly benefit from your views on the 1995 IRS compliance initiative.

**Opening Statement of Representative Gene Green
Government Operations Subcommittee on Commerce, Consumer
and Monetary Affairs**

Thank you, Mr. Chairman for holding this hearing today. One of the main issues of this hearing will deal with the intersection of two of the more prominent issues facing this Congress and future Congresses: reinventing government and the strict budget rules that prevent us from increasing the deficit.

Both ideas originated out of the belief that the size of the bureaucracy and the obligations of the government in general have become unwieldy. But there also has to be a recognition that some increases in some federal agencies or programs are

justified on the basis of the likelihood of improved future performance. Congress must be convinced to a high degree that waivers in the budget rules are necessary, and rightly so. However, the Congress must take care not to be penny wise and pound foolish.

The Internal Revenue Services' Tax Modernization System plan may be just one of those cases. The IRS is seeking 5,000 additional full-time equivalent positions and more money to improve its technological and investigative capabilities. Some analysts claim that this short-term investment will yield long-term results in the forms of improved customer service, reduction of fraud, and increased collection of tax revenues.

I am sure I am not alone among my colleagues in my eagerness to see such results. It is now incumbent that today's panel make a strong case for Congress to take the required steps to make those results a reality.

Mr. SPRATT. Now, with that introduction, let me turn the floor over to you, Madam Commissioner, and welcome you once again to our committee. We look forward to your testimony. We have your prepared testimony. We will make it a part of the record, so if you see fit to summarize parts of it, it will nevertheless be in the record.

The floor is yours.

STATEMENT OF MARGARET MILNER RICHARDSON, COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY MICHAEL DOLAN, DEPUTY COMMISSIONER; LARRY WESTFALL, MODERNIZATION EXECUTIVE; HANK PHILCOX, CHIEF INFORMATION OFFICER; DAVE MADER, CHIEF, MANAGEMENT AND ADMINISTRATION; AND JUDY VAN ALFEN, CHIEF, TAXPAYER SERVICES

Ms. RICHARDSON. Thank you, Mr. Chairman. I appreciate the introduction and I would like to summarize our written testimony.

Mr. Chairman and distinguished members of the subcommittee, I appreciate the opportunity to be here today to continue discussing our plans for reinventing the Internal Revenue Service to better serve the American taxpayer and to increase voluntary compliance.

With me today are Michael Dolan, who is the Deputy Commissioner, on my right; the IRS' Modernization Executive, Larry Westfall, on Mr. Dolan's right; the Chief Information Officer, Hank Philcox, at the end of the table; Dave Mader, who is on my left, is the Chief, Management and Administration; and our Chief, Taxpayer Services, Judy Van Alfen, who is immediately behind me, as there wasn't room at the table for her.

Mr. Chairman, we are moving ahead with our plans to reinvent the IRS and to make our business vision, the vision of how we will conduct our business in the future, a reality. Since my last appearance before this subcommittee, on November 17, we have announced more details about our reorganization plan, and we have awarded a number of the most significant Tax Systems Modernization contracts.

As we discussed at that hearing, assuring the security and integrity of our computer systems and the confidentiality of taxpayer information is perhaps the most important responsibility that the Internal Revenue Service has to the American public. Tax Systems Modernization enhances our capabilities to meet that responsibility.

Today, in addition to discussing the status of our reinvention efforts, I want to focus on our Tax Systems Modernization procurements and on our human resource planning. I also want to report on the status of proposed Tax Systems Modernization legislation that you mentioned in your opening statement and to provide you with an overview of the two most important parts of our proposed fiscal year 1995 budget, an increase for Tax Systems Modernization and the funding requested for a tax compliance initiative.

On November 30, 1993, we announced our decision to consolidate the returns processing operations, now performed in 10 service centers, into five submission processing sites. We also announced our decision to consolidate the 70 telephone sites that we now have in 44 geographic locations into 23 customer service sites.

These site selections were based on a carefully developed set of criteria which took into account factors such as cost, productivity, quality, ability to recruit, and work force diversity. Application of these factors allowed us to make our selections in a fair and consistent manner—designed to assure the best performance at the lowest cost.

Although we recognize that the transition to our business vision cannot occur overnight, we are making significant progress. Today I want to highlight for you some of the major activities that we have underway.

The five submission processing centers are going to look very different from the 10 service centers we have today. They will receive, control, image, and process paper tax returns, information documents, W-2's, and correspondence. Employees at submission processing centers will also resolve errors that do not require taxpayer contact.

While electronic filing is at the core of our business vision, we are also implementing the technological changes that are needed to process much more efficiently the paper documents that we still will receive. The heart of our future paper processing, storage and retrieval operation is our document processing system, which is being developed in Austin, TX, and is now scheduled to be piloted in fiscal year 1995. The \$1.3 billion award of this major procurement was announced last week, and the major document processing system hardware acquisition will occur in fiscal year 1996.

A version of this technology, which we call the service center recognition input processing system, is being piloted at our Cincinnati service center. This is a character recognition and imaging system for processing our simpler documents, such as Federal tax deposits, information returns, employment tax returns, and Forms 1040EZ. Upon completion of that pilot, we are scheduled to install the system in the four remaining submission processing centers later this year.

The 1040PC is another approach we are testing to reduce the amount of paper and increase our efficiency in processing. This alternative allows taxpayers and practitioners, using personal computer software, to prepare returns in a shortened format. The 1040PC contains only the line entries needed by the taxpayer to file the return without the associated narrative.

The printed 1040PC format can reduce a typical 12-page return to 2 pages, and the software can eliminate some common errors taxpayers may make when transferring figures from worksheets to the tax return. We have already received about 874,000 1040PC returns this filing season.

Today, as you know, we provide account-related taxpayer inquiries and correspondence service in many types of locations. We have a customer service concept of the future that will blend these activities and rely heavily on telephone assistance. The customer service concept will provide taxpayers with the information and assistance they need to comply with the tax laws. It will also provide us with early opportunities to resolve payment and filing issues and collect amounts due.

Effective telephone contact with taxpayers depends upon automated menus and scripts developed with the needs of taxpayers in

mind, including language and instructions that are clear and understandable. Taxpayers have told us, in customer interviews, that they want to be assured they can talk directly with a tax assister, if necessary. They have said that critical to the success of a voice response unit is access to a live assister as well as short, easy menus and brief waiting times. We are listening to what they have to say.

We understand that access to our telephone system is critical to the success of the customer service concept, and we are taking numerous steps to assure accessibility. We have recently implemented a customer service network that will allow us to transfer calls so they can be answered more timely. We have added additional telephone equipment with automated call distributors, and we have offered extended hours of service over some weekends and holidays.

An example of the flexibility in our telephone assistance that we have been able to incorporate already was recently demonstrated in California. We were able to provide assistance to California earthquake victims by transferring our telephone workload from our California phone sites so that those assisters could support the Federal Emergency Management Agency effort. Those assisters then helped over 28,000 taxpayers by providing them with their records and other relevant tax information, so that the taxpayers could take advantage of available disaster assistance.

Last July we announced that 3 computing centers, instead of the 12 we currently have, would be responsible for all of our corporate computing in the future. Our business vision is based on an environment where returns are filed and payments are made electronically. We are already making this electronic environment a reality.

In January, we awarded the corporate systems modernization contract, which will allow us to replace our existing mainframe computers that will run out of capacity by 1995, with more efficient ones. This award will allow us to stay in the business of updating taxpayer accounts, to make some modest improvements in the amount of taxpayer information we can access, to greatly enhance storage capacity for disks and tapes, and to realize immediate productivity gains. Basically, it bridges the interim between now and our full implementation of Tax Systems Modernization.

Another major procurement, which will take place next year, is the service center support system contract. This contract moves us away from having employees manually enter data to complete on-line access of tax information by front-line employees. Such access results in prompt resolution of taxpayer issues.

We are continuing to phase in the electronic funds transfer system for the payment of Federal tax deposits. Electronic funds transfer of Federal tax deposits will accelerate funds to the Treasury and reduce the paperwork burden on taxpayers. This system reflects a major step forward in shifting from a paper remittance processing environment to an information processing environment. By 1999, we anticipate that more than 85 million business tax payments will be made electronically.

Electronically filed returns have proven benefits, including fewer errors, which means fewer IRS notices and fewer contacts with taxpayers. Through February 25 of this year, we had received 9.9 million electronically filed returns, compared to 9.2 million for the

same period last year. Actually, as of the end of last week, we have had about 11.2 million filed.

In 23 States, joint electronic filing is also an option, which means that taxpayers can satisfy both State and Federal obligations with a single electronic transmission. We have received over 842,000 joint electronically filed returns, which represents a 56-percent increase over last year. We are offering electronic preparation and filing at over 40 of our offices this year, and we plan to expand that service to additional offices next year.

In addition, we are testing the feasibility of filing returns from home computers through an "on-line provider" of network services. We have also continued the growth of our Telefile Program, which permits taxpayers to file from home or from anywhere they can use a touch-tone telephone. Telefile is now available in seven States, and as of March 6, 1994, we have received over 435,000 returns on Telefile, compared to 176,000 during that same period last year.

We are also aggressively changing our district office operations by utilizing a better balanced approach among education, advanced compliance research, and enhanced enforcement. Enhancing our research capabilities is the linchpin of improving our compliance efforts. Those research and compliance capabilities will be greatly improved by our compliance research information system, our totally integrated examination system, an integrated collection system, and an integrated case processing system.

This last system is the system that will pull together, over time, each of the three systems I just referred to and allow basically instant access to all of them from the desk tops of our employees.

Later this month, a number of our Tax Systems Modernization projects are going to be available for you to see here in Washington, DC. We are setting up a display of our major projects, using sample data and actual hardware. I look forward to having you, Mr. Chairman, and the other members of the subcommittee and your staff come down and see firsthand what the new IRS will look like.

Critical to achieving our business vision is the commitment and acceptance of it by our employees. They must be active participants in how we make our business vision a reality. Our employees must also be able to offer suggestions and improvements in how we do our business, in order to improve the way we accomplish our mission today and in the future.

We also recognize the vital importance of providing opportunities to our employees to realize their full potential, by giving them the tools necessary to do their jobs and in teaching them how to use those tools. For example, the former tax examiners and taxpayer service representatives at our customer service center prototype sites, in Fresno and in Nashville, have been extensively involved in defining their new positions as customer service representatives. Our employees' response thus far to this very active involvement has been extremely positive.

Work system design is an ongoing effort at the IRS to involve our employees in developing high performance work systems that enhance customer service, quality, timeliness, productivity, and employee commitment. The document processing system [DPS] described earlier is one of those systems. Over 700 employees and

managers at all 10 of our service centers and at IRS headquarters, along with representatives from the National Treasury Employees Union, have actively participated in data gathering, analysis, design, and in the review of the DPS system.

We have entered into a redeployment understanding with the National Treasury Employees Union whereby we have agreed upon an orderly transition to reinventing the way we do business, by redirecting our employees to front-line customer service and compliance work. That redeployment understanding builds on the commitment to our work force that no career or career conditional employee whose job is substantially impacted by new technology will lose his or her job.

I know Mr. Tobias, the president of NTEU, will be testifying later this morning, but I want to publicly thank him and his members for their support during this process. We have had a very constructive dialog. Although, as I'm sure you will hear later, we have not necessarily agreed on every single point, I think we have had an open and frank discussion, and I think we have done a lot toward making the redeployment agreement a reality. So I do want to thank them for their help.

You asked, Mr. Chairman, in your invitation letter about legislation that we need to implement our business vision. In our last hearing, we discussed the legislation that was needed for us to implement that vision. Two provisions were included in H.R. 3419: One provides that reproductions from digital images will have the same legal status as original documents, and the other would permit payment of Internal Revenue taxes by credit card and other commercially acceptable means that the Secretary of the Treasury deems appropriate. That legislation, I think, is currently on the House legislative calendar, having been reported out of the Ways and Means Committee.

Since our last hearing, we have also worked diligently with the Treasury Department to develop an administration package of three other legislative proposals. Those proposals are currently being reviewed at the Department. The proposal would authorize the Secretary to first prescribe the extent and conditions under which the filing of returns will be required to be made by magnetic media or electronic transmission.

Second, it would authorize the Secretary to provide for alternative methods of verifying, signing, and subscribing returns and other statements, and third, also authorize the Secretary to prescribe alternative methods of submitting written declarations, statements, or other documents required by the Internal Revenue Code to be attached to any return. This subcommittee's support for the pending legislation, as well as these proposals the Department of Treasury will be submitting, is very much appreciated, and we look forward to working with you to accomplishing and getting them enacted.

I want to turn now to the fiscal year 1995 budget. There are two parts of that I wanted to highlight. First is an increase of \$311 million for Tax Systems Modernization, which reflects our continued commitment and the continued commitment of this administration to reinvent the IRS through new business processes and advanced technology.

Equally significant is the commitment which is reflected in a \$405 million compliance initiative that is focused on reducing the budget deficit by strengthening compliance with the tax laws. We want to work with Congress to find a way to make this additional investment in tax compliance.

Over the next several years, the Internal Revenue Service will have an opportunity to realign employees from processing and accounts maintenance jobs to front-line compliance and customer service work. If we could do that, we could greatly strengthen compliance activities in future years without increasing our overall staffing.

Both Secretary Bentsen and OMB Director Panetta have recently endorsed our compliance initiative in congressional testimony. I think Secretary Bentsen said it best when he said, "We know that when we spend money to improve tax compliance, it pays us back several times over." For that reason, beginning in fiscal year 1995, the administration has proposed an additional \$405 million for increased compliance efforts, a proposal which we hope this subcommittee will support.

We think this proposal simply makes good business sense. First, the investment in compliance will yield revenue without increasing taxes. From a Federal bookkeeping perspective, the initiative will pay for itself many times over in additional receipts, even without accounting for the beneficial effect on voluntary compliance.

Second, the IRS is the principal revenue center of the Federal Government. We account for over 90 percent of all Federal receipts. Our system of taxation depends on the willingness of taxpayers to voluntarily pay their taxes. This willingness rests on the understanding that IRS has the ability to ensure that those who fail to comply voluntarily will be required to pay their proper share.

Third, our compliance programs do need to be strengthened. Approximately 83 percent of the taxes due are voluntarily reported and paid on time, but that means that approximately 17 percent are not. We estimate that for each 1-percent increase in compliance we could raise between \$7 billion and \$10 billion annually without any tax increase or without any change in the tax law.

I believe that we at the Internal Revenue Service are in an unprecedented position to improve compliance. First, compliance is a priority of mine and of this organization. Second, I have drawn clear lines of responsibility for improving compliance. As part of our national office reorganization recently, I created the position of Chief Compliance Officer, who reports directly to the Deputy Commissioner and to me.

I have taken steps to make 7 regional commissioners and the 63 district directors personally accountable for improving voluntary compliance in their areas. In each of the seven regions, we have given a senior executive the specific charter, as the regional compliance officer, to integrate our efforts in ways that will result in significant improvements in compliance.

Our effort to improve compliance is not based merely on a reliance on strict enforcement programs. We are building a compliance research capability that will allow us to see and to react to different trends among similar groups of taxpayers, to measure com-

pliance levels on a timely and frequent basis, and to assess the results of different compliance activities.

Through a combination of new technology, business systems redesign, customer service outreach, strategic partnerships, and legislative and administrative initiatives, we are confident that we can positively influence compliance rates.

Mr. Chairman, I want to thank you and the other subcommittee members for your support of our Tax Systems Modernization effort and for the advice and counsel you have offered us over the years. My colleagues and I would now be happy to try to answer any questions you or the other subcommittee members may have.

[The prepared statement of Ms. Richardson follows:]

Statement of

Margaret Milner Richardson
Commissioner of Internal Revenue

Before the

Subcommittee on Commerce, Consumer
and Monetary Affairs
House Committee on Government Operations

Progress on Reinvention and the FY 1995 Budget

March 8, 1994



**STATEMENT OF
MARGARET MILNER RICHARDSON
COMMISSIONER OF INTERNAL REVENUE**

**BEFORE THE
SUBCOMMITTEE ON COMMERCE, CONSUMER AND
MONETARY AFFAIRS
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS**

MARCH 8, 1994

Mr. Chairman and distinguished Members of the Subcommittee:

I appreciate the opportunity to be here to continue discussing our plans for reinventing the Internal Revenue Service to better serve the American taxpayer and to increase voluntary compliance. With me are the Deputy Commissioner, Michael Dolan; the IRS' Modernization Executive, Larry Westfall; the Chief Information Officer, Hank Philcox; Chief of Management and Administration, Dave Mader; and the Chief of Taxpayer Services, Judy Van Alfen.

Mr. Chairman, we are moving ahead with our plans to reinvent the IRS and to make our Business Vision -- the vision of how we will conduct our business in the future -- a reality. Since my last appearance before this subcommittee on November 17, we have announced more details about our reorganization plan, and we have awarded a number of the most significant Tax Systems Modernization (TSM) contracts. As we discussed at that hearing, assuring the security and integrity of our computer systems and the confidentiality of taxpayer information is perhaps the most important responsibility that the Internal Revenue Service has to the American public; TSM enhances our capabilities to meet that responsibility.

Today, in addition to discussing the status of our reinvention efforts, I want to focus on our TSM procurements and our human resource planning. I also want to report on the status of proposed TSM legislation and to provide you an overview of our proposed FY 1995 budget, including the funding requested for a tax compliance initiative.

PROGRESS TOWARDS REINVENTING IRS

On November 30, 1993, we announced our decision to consolidate the returns processing operations now performed in ten service centers into five Submission Processing sites which will be located at our existing service centers in Austin, TX; Memphis, TN; Cincinnati, OH; Kansas City, MO; and Ogden, Utah. We also announced our decision to consolidate the 70 telephone sites in the 44 geographic locations that we now have into 23 Customer Service sites. The Submission Processing and Customer Service site selections were based on a carefully developed set of criteria which took into account such factors as cost, productivity, quality, ability to recruit, and workforce diversity. Application of these factors allowed us to make our selections in a fair and consistent manner designed to ensure the best performance at the lowest cost.

We are continuing our efforts to identify all the actions necessary to make our Business Vision a reality. To supplement existing plans, we are developing a Business Master Plan, a document which will provide a high level view of the business, technology and human resources activities necessary to achieve our strategic objectives. The Business Master Plan will be issued this spring and will be updated

annually. We are also developing an Integrated Transition Plan and Schedule which will be our roadmap from which to manage progress in implementing our Business Vision. The Integrated Transition Plan and Schedule will enable us to manage within the Business Master Plan framework while we focus in a much more detailed way on the business, technological and human resource actions required as we reinvent the Internal Revenue Service.

Although we recognize that the transition can not occur overnight, we are making significant progress, and I want to highlight some of the major activities that are underway.

- **Submission Processing Centers**

The five Submission Processing Centers will have a very different look in comparison to our ten Service Centers today. They will receive, control, image and process paper tax returns, information documents, W-2's and correspondence. Employees at Submission Processing Centers will also resolve errors that do not require taxpayer contact.

The volume of electronically filed returns is steadily increasing, and we are developing initiatives to promote further increases, but we are also implementing the technological changes that are needed to process much more efficiently the paper documents we will still receive. The heart of our future paper processing, storage and retrieval operation is the Document Processing System (DPS). DPS is being developed in Austin, Texas, and is scheduled to be piloted in FY 1995. The \$1.3

billion award of this major procurement was announced on February 28; the major DPS hardware acquisition will occur in FY 1996.

A version of this technology, the Service Center Recognition Input Processing System (SCRIPS), is now coming on line in our pilot at the Cincinnati Service Center. SCRIPS is a character recognition and imaging system for processing our more simple documents such as federal tax deposits, information returns, employment tax returns and Forms 1040EZ. Upon completion of the pilot, we are scheduled to install the system in the four remaining Submission Processing centers later this year.

The 1040 PC is another approach we are testing to reduce the amount of paper and increase our efficiency in processing. This alternative allows taxpayers and practitioners using personal computer software to prepare returns in a shortened format. The 1040 PC format contains only the line entries needed by the taxpayer to file the return without the associated narrative. The printed 1040 PC format can reduce a typical 12 page return to two pages, and the software can eliminate some common errors taxpayers may make when transferring figures from worksheets to the tax return. We have already received 874,000 1040 PC returns this filing season.

- **Customer Service Centers**

Today, we provide account-related taxpayer inquiries and correspondence service in many types of locations including Automated Collection System sites, Taxpayer Service toll-free sites and in service center account-related activities and compliance areas. Our Customer Service concept will blend these activities. Under our Business Vision, compliance begins with customer service. Customer service will provide

taxpayers with the information and assistance they need to comply with the tax laws. It will also provide the IRS with early opportunities to resolve payment and filing issues and collect amounts due. IRS employees at our Customer Service centers will handle all taxpayer inquiries, such as early resolution of account issues, collections, installment agreements, more simple examinations, tax law questions, forms requests, and nonfiler and underreporter issues, that do not require face-to-face contact.

We have taken several major steps towards establishing our new Customer Service centers. We have developed a detailed Concept of Operations which will provide us with an operating framework for the fully operational Customer Service centers by 2001. Blended work concepts and the evolution of work from correspondence to telephone are being tested at two Customer Service prototype sites. In Nashville, we are combining our Automated Collection System and Taxpayer Service toll-free operations. In Fresno, we are testing several approaches to encourage taxpayers to use the telephone instead of correspondence to resolve account issues.

Effective telephone contact with taxpayers depends on automated menus and scripts developed with the needs of the taxpayer in mind, including language and instructions that are clear and understandable. In developing our voice response units, we have taken that into consideration with the help of the Behavioral Science Research Center at the Bureau of Labor Statistics. They also helped us incorporate the latest industry standards and practices into these automated routing scripts and menus.

Customer satisfaction is crucial in our successful movement to telephone service using voice response units. Surveys and interviews with customers revealed that they want to be assured they can talk directly with a tax assistor if necessary. Customer interviews in one pilot indicated that our "menu" scored an 86% satisfaction rating. A 1993 customer satisfaction survey revealed that for almost 60% of the taxpayers surveyed their preferred method of contact was through the telephone. They said that the characteristics critical to successful voice response units are access to a live assistor, short, easy menus and brief waiting times.

Access to our telephone system is critical to its success, and we are taking numerous steps to assure accessibility. We have recently implemented a Customer Service Network that will allow us to equalize access by transferring calls so they can be answered more timely, installed additional telephone equipment with Automated Call Distributors, and offered extended hours of service over some weekends and some holidays. An example of our flexibility in our telephone assistance was demonstrated in California. We were able to provide assistance to California earthquake victims by transferring our telephone workload from our California phone sites to other parts of the country so that those California assistors could support the Federal Emergency Management Agency effort. Those assistors helped over 28,000 of our California taxpayers by providing them with their records and other relevant tax information, so that they could take advantage of available disaster assistance.

Another example of how we are changing our business to improve service is the way we handle account inquiries. Before 1989, a high percentage of callers were able

to access the system but many were advised to call the service center to resolve account issues. With new technology and expanded authority, toll-free assistors now resolve more of the taxpayers' account inquiries immediately, saving the taxpayers time and reducing their level of frustration. From June 27 to February 26, we have closed almost 6.4 million account inquiries while the taxpayer was on the phone. This is a 31.1% increase over last year.

Based on our success at the Ogden Service Center, we have expanded the Automated Underreporter System (AUR) to three additional sites thus far this year and will implement two final sites before FY 1994 ends. AUR automatically matches wages and other income with taxpayers' tax account information to determine if they reported their income correctly. This state-of-the-art system has reduced the number of incorrect notices sent to taxpayers, thereby reducing their burden, decreasing the amount of time spent on each case, and consequently cutting the cost of our operations significantly.

- **Computing Centers**

Last July, we announced that three Computing Centers located in Memphis, TN.; Detroit, MI; and Martinsburg, WV, instead of the 12 we currently have, would be responsible for all of our corporate computing in the future. The primary mission of these centers will be to support tax processing through data processing and telecommunications infrastructure. Several major activities that will enable us to transition to our new Computing Center environment are underway.

Our Business Vision is based on an environment where returns are filed and payments are made electronically. We are already making this electronic environment a reality:

- We are developing a detailed Concept of Operations which will provide us with an operating framework for the Computing Centers of the future.
- In January, we awarded the Corporate Systems Modernization/Mirror Image Acquisition contract, which will allow us to replace the mainframe computers at the Martinsburg and Detroit Computing Centers with more efficient ones. With the existing mainframe computers out of capacity by 1995, this award will allow us to stay in the business of updating taxpayer accounts, to make modest improvements in the amount of taxpayer information we can access, to greatly enhance storage capacity for discs and tapes, and to realize immediate productivity gains. In addition, Corporate Systems Modernization will provide enhanced operational efficiencies including automated tape libraries and centralized monitoring and control.
- Another major procurement is the Service Center Support System contract. This contract continues our journey away from having employees key entering data on one system, dumping that information between service centers and computing centers, and only updating the master file accounts on a weekly basis. This procurement is a major step forward toward complete, on-line access of tax information by front-line employees which

will lead to prompt resolution of issues. The contract award for this system will take place next year.

- We are also readying our physical plants for the future. Necessary construction for the Detroit Computing Center and Martinsburg Computing Center Annex is scheduled for completion in April 1995, and the first phase of the Memphis Computing Center building is scheduled for June 1995.
- This year, we are continuing to phase in the electronic funds transfer system for payment of federal tax deposits. Electronic funds transfer of federal tax deposits will accelerate funds to the Treasury and reduce the paperwork burden on taxpayers. This system reflects a major step forward in shifting from a paper remittance processing environment to an information processing environment. By 1999, we anticipate that more than 85 million business tax payments will be made electronically.
- Electronically filed returns have proven benefits, including fewer errors, which means fewer IRS notices and contacts with taxpayers, prompter refunds and an option that allows taxpayers to have their refunds deposited directly with a financial institution. Through February 25, 1994, we have already received 9.9 million electronically filed returns compared to 9.2 million for the same period last year. This represents a 7.6% increase. Joint electronic filing is also an option in 23 states, including South Carolina, which means that taxpayers can satisfy both state and federal obligations with a single electronic transmission. We have received over 842,000 joint

electronically filed returns, a 56% increase over the prior year. We are offering electronic preparation and filing at more than 40 of our offices, and we plan to expand this service to additional offices next year. In addition, we are testing the feasibility of filing returns from home computers through an "on-line provider" of network services.

- We have also continued the growth of the Telefile program. Telefile permits taxpayers to file using their touch-tone telephones. It is now available in seven states, including South Carolina, and as of March 6, 1994, we have received over 435,000 returns on Telefile, a 247 percent increase over the same period last year. We had projected that about 550,000 returns would be filed using Telefile this filing season, and we anticipate that we will definitely exceed that number.

- **District Offices**

We plan to enhance our front-line, face-to-face taxpayer contact operations in our district offices, utilizing a better-balanced approach among education, advanced compliance research, and enhanced enforcement. Enhancing our research capabilities is the linchpin of our compliance improvement efforts. Our research and compliance capabilities will be greatly improved by:

- The Compliance Research Information System (CRIS) will enable us to measure voluntary compliance levels nationally and locally. CRIS will be prototyped and then installed in 31 primary (Including International) and 33 satellite district office research and analysis sites across the country.

- The Totally Integrated Examination System (TIES), successfully tested in the Ogden Service Center and the Dallas District Office, will be installed in five more districts -- Aberdeen, Boise, Las Vegas, Phoenix and Sacramento -- this year. TIES will substantially improve our examiners' productivity and will be a significant benefit to taxpayers, since it will reduce the time period to complete an examination by as much as several months.
- The Integrated Collection System (ICS), which automates the assignment and management of active collection cases has been prototyped, and we are in the final stages of evaluating those results. From our preliminary evaluation, it appears that both the IRS and taxpayers will benefit.
- The Integrated Case Processing System -- is a fully integrated system which will fold together over time CRIS, TIES and ICS. While the initial designs for these systems were originated in independent compliance functions, our controlling project structure will ensure that they are fully integrated.

Later this month, a number of the TSM projects I have described will be available for you to see here in Washington, D.C. We will have a display of most of TSM's major projects using sample data and actual hardware, and I look forward to having members of this Subcommittee and their staffs see firsthand the new IRS.

HUMAN RESOURCE PLANNING

Critical to achieving our Business Vision is the commitment and acceptance of it by our employees. They must be active participants in how we make our Business Vision a reality. Our employees must also be able to offer suggestions and

improvements in how we do our business in order to improve the way we accomplish our mission today and in the future. We also recognize the vital importance of providing opportunities to our employees to realize their full potential by giving them the tools necessary to do their jobs and teaching them how to use those tools.

- **Employee Involvement**

The former Tax Examiners and Taxpayer Service Representatives at the Customer Service Center prototype sites in Fresno and Nashville have been involved in defining their new positions as Customer Service Representatives. Extensive research has been conducted to determine the proper skills for this new "blended" position. A skills analysis, which assesses the employee's current skill level against the required skills for the new position is being evaluated throughout the prototype process. Any identified "skills gap" will be used to customize training for employees with similar needs. Employee response to this level of involvement has been very positive.

- **Working Environment**

We also recognize the importance office environment plays in our efforts to change the way we do business. To ensure re-engineered space is available when needed, we have entered into a unique partnership effort with the General Services Administration (GSA) to coordinate development of the Submission Processing sites. We are meeting with GSA to discuss site-by-site design criteria, temporary space needs, transition plans, budget requirements, and implementation schedules. With the excellent service and cooperation we are receiving from GSA, we anticipate meeting all

of our schedules. Phase I of the Austin Submission Processing center is scheduled to be completed in January 1995.

- **Work Systems Design**

Work Systems Design is an ongoing effort in the IRS to involve employees in developing high performance work systems that enhance customer service, quality, timeliness, productivity, and employee commitment. It brings together all of the organization, people, information technology and workplace issues. The Document Processing System (DPS) described earlier is one of those systems. Over 700 employees and managers at all ten service centers, IRS headquarters, and representatives from National Treasury Employees Union (NTEU) have actively participated in data gathering, analysis, design, and review of the DPS system.

- **Employee Redeployment Strategy**

On November 24, 1993, the NTEU and IRS entered into a Redeployment Understanding whereby we agreed upon an orderly transition to reinventing the way we do business by redirecting our employees to front-line compliance and customer service initiatives. That Redeployment Understanding builds on our commitment to our workforce reflected in Policy Statement P-0-112, that no career or career-conditional employee whose job is substantially impacted by new technology will lose a job. The Redeployment Understanding was developed through cooperative IRS-NTEU efforts working outside the traditional negotiation process.

LEGISLATION NEEDED FOR OUR BUSINESS VISION

At our last hearing we discussed the legislation needed for us to implement our Business Vision. Since that hearing, we have worked diligently with Treasury to develop an Administration package of these legislative proposals. We submitted five legislative proposals along with draft legislative language to the Department of the Treasury in December 1993, and that legislation is currently being reviewed by the Department. The five proposals are:

- Electronic Filing of Returns: Authorize the Secretary to prescribe by regulations the extent and conditions under which the filing of returns will be required to be made by magnetic media or electronic transmission.
- Alternative Methods for Verifying Returns: Authorize the Secretary to provide for alternative methods of verifying, signing, and subscribing returns and other statements.
- Alternative Methods for Submitting Attachments to Electronically Filed Returns: Authorize the Secretary to prescribe alternative methods of submitting written declarations, statements, or other documents required by the Internal Revenue Code to be attached to any return.
- Use of Reproductions of Returns Stored in Digital Image Format: Provide that reproductions from digital images have the same legal status as original documents. This provision was included in HR 3419, which has been reported out of the Ways and Means Committee and has been placed on the House legislative calendar.

- Payment of Tax by Credit Card: Permit payment of internal revenue taxes by credit card and other commercially acceptable means that the Secretary deems appropriate. (This provision was also included in HR 3419 and is supported by the Vice President's National Performance Review report.)

The Subcommittee's support for these proposals is very much appreciated.

FY 1995 BUDGET

Our proposed FY 1995 budget of \$7.613 billion and 109,656 FTE represents an increase of \$261 million or 3.5 percent, but a decrease of 3,169 FTE over FY 1994 levels. The \$311 million and 229 FTE increase for Tax Systems Modernization--reflect our continued thrust to reinvent the IRS through new business processes and advanced technology. Highlights of the budget request include:

- Three new user fees totalling \$147 million, proposed as offset to our appropriation request, are for special services to particular taxpayers that are beyond normal filing or payment obligations. They include: (1) a direct deposit indicator charge for financial institutions who have requested the direct deposit indicator in connection with electronic filing refund anticipation loans (\$87.2 million); (2) installment agreement charges (\$54.4 million); and (3) an increase in the amount of tax return copy fees (\$5.0 million).

- A \$405 million and 5000 FTE Compliance initiative focused on reducing the budget deficit by strengthening compliance with the tax laws.

- The FY 1995 budget reflects the Administration's plan to work with the Congress to find a way to make an additional investment in tax compliance. Over the

next several years, IRS will have an opportunity to realign employees from processing and accounts maintenance jobs to front line compliance and customer service work, which would permit us to greatly strengthen compliance activities in future years without increasing overall IRS staffing.

As Secretary Bentsen stated in his testimony before the Budget Committee in February, we need to make a special effort to collect more of the taxes that are on the books now, and we should start immediately. We know that when we spend money to improve tax compliance, it pays us back several times over. Therefore, beginning in FY 1995, the Administration has proposed an additional \$405 million for increased compliance efforts. We think that this approach would promote sound tax administration and make good business sense:

- First, this investment yields revenue without increasing taxes. From a federal bookkeeping perspective, the initiative will pay for itself many times over in additional receipts, without accounting for the beneficial effect on voluntary compliance.
- Second, the IRS is the principal revenue center of the Federal government, accounting for over 90 % of all receipts. Our system of taxation depends on the willingness of taxpayers to voluntarily pay their taxes. This willingness rests on the understanding that IRS has the ability to ensure that those who fail to comply voluntarily will be required to pay their proper share.
- Third, our compliance programs need to be strengthened. Approximately 83 percent of taxes due are voluntarily reported and paid on time. That means that approximately 17 percent are not. We estimate that for each one percent increase in

compliance, we can raise between \$7 and \$10 billion annually, without any tax increase or a change in the tax law.

- I believe that the IRS is in an unprecedented position to improve compliance with the tax laws. First, compliance is a priority of mine and of the organization.

Second, I have drawn clear lines of responsibility for improving compliance:

- As part of the National Office reorganization, I created a Chief Compliance Officer who reports directly to the Deputy Commissioner and me;
- I have taken steps to make the seven Regional Commissioners and 63 District Directors personally accountable for improving voluntary compliance in their areas; and
- We have given a senior executive in each of these regions specific charters as Regional Compliance Officers to integrate compliance efforts in ways that will undoubtedly result in significant improvements.

Our effort to improve compliance is much broader than a reliance on strict enforcement programs. We are building a compliance research capability that will allow us to see and react to different trends among similar groups of taxpayers, measure compliance levels on a timely and frequent basis, and assess the results of different compliance activities. In addition, our Enforcement Revenue Information System is tracking actual case results -- not just how successful we are at various stages of working a case and for the first time in our history we will have a management information systems that will allow us to use our resources more effectively. Through a combination of new technology, business systems redesign,

customer service outreach, strategic partnerships, and legislative and administrative initiatives, we are confident we can positively influence compliance rates.

CONCLUSION

We are making significant progress in our effort to reinvent the IRS. In addition, we have a strategy for investing the productivity savings from TSM so that they will yield positive results -- increased revenue and improved voluntary compliance. Every law abiding citizen should applaud these efforts.

Mr. Chairman, I want to thank you and the other Subcommittee members for your support for our TSM effort and for the advice and counsel you have offered us. My colleagues and I will be happy to answer any questions you or the other Subcommittee members may have.

Mr. SPRATT. Thank you very much.

In deference to the fact that Ms. Margolies-Mezvinsky has to be somewhere at 10:15, I am going to turn to her.

I will defer my own time and allow you to ask the questions you have.

Ms. MARGOLIES-MEZVINSKY. Thank you very much.

We heard that the number of nonfilers is more than 10 million. What impact will the compliance initiative have on reducing this alarming number? You started to give us some indication. Could you continue?

Ms. RICHARDSON. Yes. One of the initiatives that we began, I guess over a year ago now but plan to continue, is to really focus on our nonfiler population, which at the present time we estimate to be about 7.5 million individual nonfilers and about 2.5 million business nonfilers.

I think Mr. Dolan might like to address, in specific detail, what we are hoping to do with this initiative.

Ms. MARGOLIES-MEZVINSKY. Could you tell us who the typical nonfiler is? I mean, I know that there is not a typical nonfiler, but there are certainly groups.

Mr. DOLAN. Actually, our experience is that the typical nonfiler has turned out to have a profile much more generic than we had thought.

Frankly, we found a much larger percentage of the nonfiler population to be people that, in the first instance, made what might look like a fairly human decision in the face of some form of personal or business tragedy or crisis or some other reason, whether it be a divorce, a failed business, or a death in the family. They made that first judgment to either miss a filing date or had some problem with an original due date.

Subsequently, it has snowballed. The first year, the person is out. When it comes the second time to file or not file, some of the reservations we learned about were their fear of what was going to happen to them when they tried to reenter the system. Some people felt that they faced sure criminal prosecution. Others felt that they faced a kind of payment ultimatum from us that would bankrupt them.

So what we have done is try to put a multifaceted approach together for that segment of the nonfiler population; people who, through some relatively human set of circumstances, fell out in the first instance. We've been very heavy on the education. We've been very heavy on the invitation to come in, get our assistance in getting your back returns. If it requires a payment agreement, we will structure such a payment agreement. So we have done that.

Ms. MARGOLIES-MEZVINSKY. Any amnesty?

Mr. DOLAN. I'm sorry.

Ms. MARGOLIES-MEZVINSKY. Any kind of amnesty?

Mr. DOLAN. Not amnesty in any classic sense. In some of those instances, penalties that might otherwise have applied have been waived on the basis of whatever probable cause that the taxpayer has given us that underlies their original nonfiling.

Ms. MARGOLIES-MEZVINSKY. In that 10 million group, what is the percentage of those people who have just, through human problems, fallen through the cracks.

Mr. DOLAN. At this point, it would be tough for us to extrapolate on the whole 10 million population. I would say that well over half of the people who have come back in, either the folks that we have identified as known nonfilers, people for whom we had some record on file, and then there is another whole slice of people who had dropped out of the system either so long ago or have never been in. There are about 60,000 of those people who have come back in.

I would say well over half of the people that we have seen come back into the system would meet, generally, the definition that I described earlier as somebody whose personal circumstances fell into that kind of category.

We do have, though, a middle category where we have spent 2,000 examination staff years, over the last 2 years, identifying from our information sources and from other data those that look like they are most likely the higher dollar, higher income folks who have not come back in. And we have engaged them in a fairly classic examination encounter.

Then, on the other end of the spectrum, we have people who we are pretty certain have plotted to be outside the system, and we have engaged them in the full thrust of our criminal prosecution efforts.

So we have attempted to go at the market in different ways, depending upon the differences among our customers, and we are finding that it has been a pretty successful endeavor.

Ms. MARGOLIES-MEZVINSKY. It was my fault that you got off on this tangent, but if you could explain what it would mean.

Mr. DOLAN. On the actual revenue initiative?

Ms. MARGOLIES-MEZVINSKY. Yes.

Mr. DOLAN. What we will do next year, as part of the \$405 million initiative is, continue a shift toward more business taxpayers. The actual collection portion of the initiative calls for us, in the first year, to yield about \$320 million that would come from closing 42,000 delinquent cases, cases that to us are predictive of somebody's requirement to file.

We also will probably bring in somewhere in excess of 55,000 additional delinquent tax returns.

So that is the place that the collection initiative, as part of this \$405 million, is designed to hit—on nonfilers. We also are trying very hard, with that collection piece, to hit the universe of accounts receivable, those that are already in our queue, they are due and owing, and for lack of resources, we are unable to get to today.

Ms. MARGOLIES-MEZVINSKY. Of the 10 million, do you have any estimates as to how many nonfilers will become filers under the new plan?

Mr. DOLAN. I wish we had a science that would give us that with any precision. What we are finding is that a significant percentage of the nonfilers are people who have refunds due. And we are finding that there are also significant—when we look back at 3 or 4 years, we find some of those nonfilers are people who had a requirement in 1 year but not in 2.

So it's very hard to generalize that, of the 10 million, we will get X back and Y will stay in the system, although we are trying. We now have a longitudinal study looking at the people who have come back in the first 2 years of this program, making sure that those

who should stay in do not drop out again. But it is hard to project against the total 10 million universe.

Ms. RICHARDSON. One other piece I think that it is important to focus on, also, is the ability to match information documents more currently. A number of our so-called known nonfilers are known to us because we do have some information on them. So some piece of our initiative will also be aimed at stepping up our document matching efforts on the information returns piece.

Mr. DOLAN. That's an excellent point. The Commissioner makes note of the document matching. We project in the initiative that we—actually, this year there were 34 million what we call nonperfected information documents that represent a huge chunk of money. Now, an awful lot of that we know does ultimately get reported, but inasmuch as they are unmatched at this point, that's a significant opportunity for us to look for nonfilers.

Ms. MARGOLIES-MEZVINSKY. Thank you very much.

Thank you, Mr. Chairman.

Mr. SPRATT. Thank you very much.

Mr. Cox.

Mr. COX. Thank you, Mr. Chairman.

The Office of Management and Budget has suggested that the IRS pursue a pilot program, hiring a private collection agency in order to enhance collection. Is that something that the Service is moving on?

Ms. RICHARDSON. I believe, in the fiscal year 1994 budget, there was a request for funding for such an initiative. Given the fact that we were unable to get all of the funding we needed for our Tax Systems Modernization and a number of other programs, we did not have any money in our fiscal year 1994 budget to fund even a pilot study.

I am very concerned. I think we are concerned about our accounts receivable, and I think we need to look at a number of options. But at the present time we have no plans to contract out our collection activities. I think it is a subject that really needs a lot of careful review, given the sensitivities of collection issues.

Mr. COX. Now, the compliance initiative is aimed at collection, is it not?

Ms. RICHARDSON. It is, very definitely, but it is aimed at moving into the areas where we know that we can effectively use our collection resources and not a pilot project where the outcome might be very uncertain and unpredictable.

Mr. COX. The reason, of course, for a compliance initiative is that the status quo is not tenable.

Ms. RICHARDSON. That is correct.

Mr. COX. We have our delinquent accounts increasing. We have our collections declining at the same time, the obverse of the same problem. It went from \$62.5 billion in delinquent accounts in 1992 to \$63.2 billion in 1993. And our collections dropped, during that period, from \$24.2 billion to \$22.8 billion in the last year.

OMB, responding to this, suggested a pilot program, and what IRS is doing is taking all of the savings, I take it, from your systems modernization, the 3,612 full-time employee positions that we saved or will save through the end of the current fiscal year, and another perhaps 1,100 full-time employee positions for fiscal 1995,

that adds up to 4,700 and some, pretty close to the 5,000 positions that we are looking at putting into a compliance initiative.

That is sort of a self-funded initiative, as a result, paid for by the positions that we eliminated through systems modernization. Couldn't we use that source to have a pilot program, which is all that OMB suggested, in collections, using a collection agency? Why wait?

Ms. RICHARDSON. We feel that, with the 5,000 additional FTE's for the compliance initiative, we have specific areas where we could make very effective use of those people to address specific compliance problems.

I have talked to Mr. Tobias, and we would like to sit down and work out a proposal to address the accounts receivable. We are quite concerned about it. But I do not think, at the present time, that we have sufficient evidence to give us any comfort that using those resources in the private collection area would yield us nearly as much benefit as using the resources that we——

Mr. COX. But isn't the purpose of a pilot program to provide you with some empirical data? We are not talking about turning over all collections to collection agencies, but, rather, basing a decision whether to move in that direction on some authentic empirical data rather than mere surmiser preference or the position of union leaders.

Ms. RICHARDSON. In the current year, we had our employees already trained and on board, and we felt we could make better use of them rather than spending what few resources we had. We had additional requirements in the motor fuel excise tax area and in the earned income tax area and the refund fraud area that we felt we needed to expend our resources on. So that's why we did nothing—or that was one of the reasons we felt it was not wise to embark on that pilot in 1994.

For 1995, most of that money, I think, is programmed in various compliance initiatives.

Mr. COX. You have three general categories for the compliance initiative to pursue: The first is audits, basically focused exams; the second is collections; and the third is more effective use of information reporting documents.

I wonder if you could talk about the second, collections, and the specific things that the compliance initiative intends to do in the collections area.

Ms. RICHARDSON. I think Mr. Dolan might address that. It really is a followup to what he was talking about in the nonfiler strategy.

Mr. DOLAN. Mr. Cox, we have looked at three principal ways in which we think it would be prudent in spending the collection portion of the initiative. The first is in accelerating the business delinquencies, and particularly the employment-related type delinquencies. That is right now, both in terms of the actual tax delinquent accounts, the amounts due and owing, as well as the quarters for which there are delinquent returns to be filed, a significant part of both the tax gap and we think an insidious part of the pyramiding process.

If you cannot deal with a businessman or woman early in their difficulties, and you wait for six or seven quarters, that's an insid-

ious kind of problem that doesn't work for the government or the individual. That's the first problem.

The second is a very substantial growth in our bankruptcy inventories almost every place around the country. In working with U.S. trustees, I think there are some concerns about the way that the government is able to protect the government's interest in claims in a massive bankruptcy work that is essentially sitting, a good portion of it, in our docket.

The third piece is what we would call our field high-dollar inventories. Today we have cases that are essentially in a queue, meaning that we are not able to get them in the hands of a revenue officer that, by our last estimate, are somewhere in the neighborhood of \$2 billion worth of work. If we were able to put it into the hands of our field revenue officers, if we had sufficient revenue officers to work that work, that looks like collectible accounts receivable.

Those would be the three places that we would make the principal thrust of the collection piece of the \$405 million initiative.

Mr. COX. Now, your field high-dollar inventories, therefore, sound like nearly 10 percent of your existing collections. That is to say, in 1993 we collected \$2.8 billion, if you have \$2 billion that you think is collectible in field high-dollar inventories, you would bump up your collections by about 10 percent; is that right?

Mr. DOLAN. I do not make the claim—I wish I could—I do not make the claim that the piece of the \$405 million initiative that we can put in the field will get that \$2 billion.

Mr. COX. But that's what is out there, you think?

Mr. DOLAN. The \$2 billion is the most collectible of what is available to our field resources.

Mr. COX. What is the technique that one follows in getting after a case that might comprise part of the overall caseload of field high-dollar inventories?

Mr. DOLAN. Are you asking to focus on the field portion of that or the whole cycle?

Mr. COX. Well, actually, the field portion of it, the collection portion.

Mr. DOLAN. Essentially, what happens is, by the time a field—

Mr. COX. And with particular reference as to how the collection initiative is going—or the compliance initiative is going to focus on this problem.

Mr. DOLAN. Well, can I back you up just a minute? Not to evade the field part of it, but part of where we will spend some of the resources particularly in the business accounts I talked about, is in both our service centers and our automated call sites, because we go through a process today that involves notices, telephone contacts, before we actually put it in the hands of a field person.

We have found that the efficiencies and the effectiveness in both the automated call sites and in the service center collection branches are significant, if we can get them to work early enough and get them to make the telephone contacts, which is an overall part of our strategy to try to get maximum contact on the telephone and try to get it resolved early. So some portion of our resource will go there.

But then this residue that I talked about as being the field component. That is a case that has been worked through those steps,

the person has typically gotten four notices, they typically have gotten a telephone call. Typically, we would have tried, had we known about a place of employment or a place of banking, there would have been, potentially, a lien and a levy or just a levy initiated against a known source of funds.

And it is at the point that none of those efforts have resulted in a full payment that the case will typically get in the hands of one of our senior field people. That is the person who then attempts to locate assets that otherwise have been unknown to us. That is the person who makes the face-to-face contact. That is the person who tries to work through a payment arrangement that will satisfy the account.

Mr. COX. So the totality of this, comprising what you do back in the office and out in the field, is notices, telephone contacts, liens and levies against bank accounts and other assets, personal visits, meetings designed to negotiate payment arrangements. Isn't that exactly what collection agencies do?

Mr. DOLAN. Well, I guess, in one form or another, yes. There are some very material differences.

Mr. COX. Why is it that we believe that, therefore, we shouldn't even undertake a pilot program to find out whether or not we could augment our existing efforts more successfully. Because what we have been seeing is that doing it the current way is yielding increasing poor results.

Mr. DOLAN. Can I strike a couple of predicates to your question? One is, I think, in terms of increasingly yielding poor results, I think some part of what is masked in the numbers you used, in terms of total collections 1 year to the next, is an appreciable drop-off in the first and second notices. That is when people voluntarily pay upon just getting a computer-generated notice.

That is typically a function of the economy, much of it induced by what happened, I think, last year, in terms of the withholding tables and people who found themselves underwithheld, and, therefore, they become "balanced due" people at the end of the filing seasons. So that is not a commentary on, as a matter of fact, the field effectiveness and efficiency. The field revenue officers' results, as measured in dollars collected per staff year expended, are up, as part of that equation.

But to the second part of your comparison of our collection process with a private one, there are a number of material ways in which the Federal process of collecting taxes, I think, are different. One is, there is an extraordinary obligation that we have with respect to the confidentiality of tax information, that is not mirrored, at least as I know, in almost any other private collection enterprise.

Second, there are a number of Federal faculties available to us, as Federal tax collectors, in the liens and levies, various forms of restraint, that are also not a part of the way that a private collection agency can do its business.

So I think that it is not direct analog to think in terms of the two processes.

Ms. RICHARDSON. I fully concur with what Mr. Dolan has said. I think to be somewhat more responsive, Mr. Cox, we do need to explore what possible options are available and where we can use

some other resources that we have not used in the past. But I think we really feel that we have people on board, we are making some progress. There were some peculiar things about last year with the withholding and that situation that may have distorted those numbers that you have.

I think we would be remiss in not looking at other options or outside possibilities and data bases, but I am reluctant to use resources that we think we can use more effectively in private collection efforts when we really do feel that we are in a position to make a difference by using our own employees.

Mr. COX. I will wrap up this line of questioning by saying that it strikes me as recalcitrant to say that you're basing it on feelings. You're not rebuffing Chris Cox; you're rebuffing the Clinton administration's OMB. They are the ones who have suggested this.

Ms. RICHARDSON. We are working with them and talking to them about what possible steps we should take, in terms of looking at other alternatives. But in terms of our compliance initiative——

Mr. COX. But rather than basing it on feeling——

Ms. RICHARDSON. I beg your pardon.

Mr. COX [continuing]. With all due respect, we ought to base it on actual empirical data. What I'm hearing is that the IRS refuses to conduct the experiment to find out, on the basis of real evidence, whether this will work or not. And the highest priority, instead, seems to be maintaining all the existing labor force that possibly we can.

We enter into the analysis, spending billions of dollars on TSM, with the presumably labor-saving equipment, all to the end of maintaining all of those positions or so many of them that we can put 5,000 people into this compliance initiative, raising questions about whether clerical personnel, the data entry people whose jobs are being eliminated by this equipment, can be trained to do sophisticated audit work, or collections, and so on.

Then we are told we haven't any money at all to do a pilot program, as OMB recommends, in using a collection agency. It strikes me that there is an agenda rather than good management practice seeking the best results based on real world, empirical evidence. We are just trying to close our eyes to the evidence. We do not want the experiment. We do not want to know what the result would be. We feel that we can do it better without even testing those waters.

Ms. RICHARDSON. I hope you wouldn't leave with that impression, because I do not think that it would be accurate.

We had choices for fiscal year 1994 that we had to make, and we had specific compliance areas where we felt we needed to use our resources, including, in the motor fuel excise tax area and the refund fraud area, those areas are where we chose to use our resources. Because the funding increase we got last year was basically needed to fund the geographic pay initiative, we virtually had no increase in funding when all was said and done.

The other thing I also want to make sure that people on this subcommittee understand is, although the initiative speaks to 5,000 additional FTE's, the base budget is a reduction of 3,000 over where we are today. We currently have in our operating plan in excess of 112,000 FTE's. The base budget is in the neighborhood of

109,000. So we are talking, at most, about a net increase of 2,000 FTE's over where we are today, not 5,000 FTE's.

Mr. COX. But an increase over where we are today is an anomaly, given that we are investing billions of dollars in equipment that is obsoleting many positions.

Ms. RICHARDSON. Well, it is, but we also have not reinvested those positions in compliance-related activities. I think what we are here to talk about today is the fact that, with the reinvestment of those people in compliance-related activities, we could make a significant difference in compliance levels in this country.

I think Mr. Mader, who is our Chief, Management and Administration, wanted to touch on one point for you also.

Mr. MADER. Mr. Cox, you mentioned converting clerical employees to compliance type of employees. Over the past 4 years, the Service has been successful in converting over 4,000 people in clerical types of activities into tax examiner activities, which are the beginning of compliance.

Mr. Dolan mentioned the kind of work that exists within the \$405 million initiative. It is that very kind of work that these tax examiners are trained to do. And, as the Commissioner testified, these are people who are here now. We do not need to reinvest additional training; they are ready to do the job now.

So we have a track record of being able to convert people from a clerical type of operation into tax examiners and putting them online and being productive. The compliance initiative just builds on that over the next several years.

Mr. COX. Yet, if the measure of our success is productivity, what we are seeing is an increase in delinquent accounts and a decrease in collections. I agree with you that you have been successful, if the measure is, people are now employed in one function and they used to be employed in another. But judging by productivity, at least overall, while we can explain it on the basis of the bad economy, or what have you, we can't show that we actually improved our collections, can we?

Mr. MADER. I would have to defer that to Mr. Dolan.

Mr. DOLAN. I think, again, we come back to the point of, if the collections number we focus on is the total collections, no. But if you want to break it down into the parts where the IRS personnel are brought to bear against the underlying delinquency, the answer is yes. That efficiency, that effectiveness tracks upward, not downward.

Mr. COX. While I am ranking member here, I feel that the chairman has been more than generous in time, and I do not want to take it all up.

Mr. SPRATT. Go ahead and complete your questions. That's quite all right.

Mr. COX. I will say, on a totally different topic, that I think an \$8 fee for direct deposit confirmation is probably sufficiently small that nobody is going to start a revolution based upon it in the near term. I am concerned about the trend, however, because the notion of the IRS charging user fees is a difficult one to come to grips with.

People really haven't any election whether to use the Service as opposed to some other tax agency to whom they might pay their

taxes. We are, after all, trying to encourage people to use electronic filing. It is precisely that population that is targeted with this fee for confirmation that there will be a direct deposit.

As I say, I think the amount is small enough, and it may be that we could justify it on the four corners because of the manner in which the refund anticipation loans are made or abused, but the concept of IRS user fees, because we are coming up with other ones, for photocopying, and so on, strikes me as a dangerous one.

These are costs that will just be added on to the amount of tax owed and, in essence, will increase the burden of tax compliance.

Ms. RICHARDSON. Mr. Cox, on that specific fee, we certainly are well aware and very concerned about the whole issue of fees. As I have often said, unlike Yosemite, some people do not want to use our services, so they may not be willing to pay for some of them. But we have attempted to select fees that would apply to special or unique services that would be provided, and that \$8 fee is not applicable to everyone who is filing electronically.

In fact, we assiduously sought to avoid anything that would cause anyone not to be willing to file electronically. It is a fee that would be paid in those situations where a bank would be making a refund anticipation loan, and it is for that direct deposit indicator, which in effect indicates that there is no Federal debt due, so that the bank would go ahead and make a refund anticipation loan. It is clearly not applicable to everyone who files electronically, only those who might deal with a bank and a refund anticipation loan.

Mr. COX. It is a subset of that population?

Ms. RICHARDSON. Very much a subset; right, and not intended to discourage—

Mr. COX. 10.9 million such returns in 1993.

Ms. RICHARDSON. That is correct. But we are very anxious to broaden the population of people who file electronically and move well beyond those who are relying on the refund anticipation loans.

Mr. COX. I appreciate that response, and I am certainly aware of the specifics of this particular fee. I express only a generalized concern that we are starting something here that we may not want to get into, which is all manner of fees for dealing with the IRS.

In theory, when somebody at the Service is working on your return, you could be charged a user fee for that. But I hope that the appropriations that Congress makes for the IRS would be sufficient to cover all the associated costs, whether they be photocopying, putting the document in the file, or what have you, so that we can have a more user-friendly bureau that people will voluntarily pay their taxes to. That's the essence of the system.

I yield back. I thank you.

Mr. SPRATT. Thank you very much, Mr. Cox.

Mr. Horn.

Mr. HORN. Thank you very much, Mr. Chairman.

I congratulate you, Commissioner. You have one of the toughest jobs in any administration, and I think you have made a very thorough statement. I wish you well. I'm sure, as the chairman has said, this committee will certainly be willing to help you on your needs for modernization.

Ms. RICHARDSON. Thank you.

Mr. HORN. Let me ask you a few questions, however, based on the testimony and based on some of my concerns.

Nothing infuriates me more than cases of noncompliance, and they occur at all levels of our income stream. One of the things that concerns me is what kind of strategy can you develop that will have the greatest payoff, because, as you note, and it's really quite astounding, your range that for every 1 percent more of compliance we will have \$7 billion to \$10 billion in tax collection.

There's approximately 17-percent noncompliance in this country. Obviously, if you take either your low figure or your high figure, that would more than half the annual deficit that we have right now, that all agencies are struggling to cope with. And we'll get to more of that later.

But what is your strategy as to how you target the various income groups in society to get the greater payoff? Obviously, certain people pay less taxes, but in the aggregate they pay more taxes, we know, than a lot of the people who have the high incomes and are avoiding taxes. I want to get everybody, frankly. So what is your strategy?

Ms. RICHARDSON. I think you have very well touched on what the concerns are, and I think we need to have a balanced approach. What we have been able to do—and I will let Mr. Dolan get into more detail—thanks to what Tax Systems Modernization capabilities we have today, we have been able to do much more sophisticated research than we have in the past, and we will continue to do more of that in the future.

Merely because you have high-income individuals does not make them noncompliant, and we are well aware of that. So what we are trying to do is trying to focus on specific areas of noncompliance through our research and through our experience, and then focus on those particular groups for stepped-up education efforts. We do believe that our compliance efforts begin with our taxpayer service and taxpayer education. We want to make certain people know what their obligations are.

There are those, upon being educated, who may still decide not to comply, and for those we do want to be able to pursue our enforcement techniques. Enforcement resources are clearly our most expensive, so we want to try to focus them in the areas where we have the highest levels of noncompliance.

Mr. HORN. What are those areas? Can you isolate them, in terms of, say, the \$200,000 and above, the \$100,000 to \$200,000, the \$70,000 to \$100,000, and so forth, the below \$40,000, whatever?

Ms. RICHARDSON. As I said, I do not think it really focuses on specific income or even asset groups. It does tend to focus more in certain kinds of areas—where clearly, we have withholding information reporting, we have extremely high areas of compliance. A wage earner who has only wages that are withheld on and are reported on a W-2—I think the compliance levels are in the high 90 percent. Where there is no information reporting, no withholding, our compliance levels can drop dramatically.

Mr. DOLAN. Mr. Horn, as the Commissioner said, one of the things that Tax Systems Modernization is already beginning to do for us is to give us access to information we have never had before.

Typically, in the past, we set our agenda, particularly in the examination and in the audit arena, by doing essentially intensive audits of a subset of the population. And then we did audits, based on what are called the TCMP, or the taxpayer compliance measurement program. You might do a sample of somewhere in the neighborhood of 50,000 of those audits and then try to extrapolate. Typically, we did try to extrapolate across asset or dollar class, and that is a huge extrapolation to try to move from that to cover as many as 200 million filed returns.

What we now have available to us is a relatively small percentage of the return information, because it's all manually entered. With the 14 million electronically filed returns this year, all that data is available to us.

So what you have now is the ability to begin to stratify and look below the sort of obvious level of dollar income and be able to look in the same business, somebody filing as a small corporation on an 1120, somebody else filing with a schedule C. In the past, we have never been able to examine the phenomena in that business or the phenomena in that market. Our strategy, if there is an overarching one today, is to be able to differentiate at that level.

What we do know, as the Commissioner has said, is there are some parts of our customer base where there is a heavy reliance on information, both as to income and as to deductions, where you can basically manage those relationships through a matching process.

But then there is a big part of our customer base, and characteristically it's somebody who is maybe a sole proprietor, probably filing an 1120S or a schedule C, where a high percentage of his or her or the enterprise's income is not accompanied by any kind of a matching instrument. That is where, as a percent of what we have to go after, is the most nettlesome.

What we have found very successful is to actually make our audit guides available to different industry groups. And we will tell the people who are in the business of running gasoline stations, or small convenience stores, or any number of small enterprises, this is the way we examine your returns; these are the issues we are looking for; and these are the kinds of points of reference that we are looking at, in terms of income and expenses.

That education and outreach attempts to work within industry groups and has put us in a different world. Always, in the past, we tried to do it case by case, after the fact, and that is a very labor-intensive, very retail-based approach that I do not think would get us to the kind of progress that Mr. Cox was talking about.

Ms. RICHARDSON. We have spent quite a bit of time over the past year, and will continue to do that in the coming year, sitting down with representatives of industry groups and, as Mr. Dolan said, talking to them about what the issues are and what our concerns are, what we are finding in audits, and working out, audit guidelines so that we are not doing something that is onerous to that industry and that they do understand what the practices in that particular industry are.

A lot of it has been an educational experience for us, as well. In the past, I think we have approached every single audit of a business in much the same way, and most businessmen would know

that you would not audit a bank in exactly the same way you might audit a grocery chain or some other kind of organization. So we are getting much more sophisticated about learning and understanding the industries that we are auditing.

Mr. HORN. Let me move to another case. We see a lot of celebrity cases, and this one is the recent case in CIA, where you have a person alleged to have been an agent for the Soviet Union, who has been alleged to have paid, in cash, a half million dollars for a house. Now, banks, when you deposit over \$10,000 in cash, a statement is required to be filed. Should we have a \$10,000 or more cash statement in a real estate transaction also filed, so we can check people with sudden cash?

I mean, I find it unbelievable CIA didn't have its own internal processes to look at this, but what about it on a national standard? If somebody is dumping a half million in cash, I think some antennae ought to go up somewhere.

Ms. RICHARDSON. Well, not to speak to the specifics of that case, because it is before the grand jury, but any cash payment to a real estate company would, in fact, be reportable. So the reporting is beyond just payments to banks.

Mr. HORN. OK. Who would get that particular filing?

Mr. DOLAN. Actually, what we could do, if you are interested, Mr. Horn, is give you a more detailed description, but there are either the currency transaction report or an 8300, depending upon whether it's a purchase of a service or if it's a bank transaction being made. Those all go to a central computer that we have in Detroit where we maintain a data base, some of which is confined to the use of the Internal Revenue Service because it is tax information, others, in the area of money laundering violations, are available more broadly to law enforcement.

That is a very key source of information for us as we are trying to identify both civil and criminal abuses, and it is also used by a variety of other law enforcement agencies. Of course, there is a whole stream of efforts made to thwart that requirement. People structure transactions so as to be below the threshold and do a variety of things designed to obfuscate that filter.

But that has been a fairly significant arrow in our quiver, with respect to looking at money laundering and tax evasion cases.

Mr. HORN. Did we happen to know about this particular case?

Mr. DOLAN. I think those are issues that we probably ought not to address in this forum, Mr. Horn.

Mr. HORN. Will they be addressed somewhere?

Mr. DOLAN. I can only assume they will be.

Mr. HORN. OK. Because I really think, if that case got by the net somehow, we need to get a lot of answers on it to find out how come. Is it just filing this stuff somewhere and, unless somebody has a tip, nobody can be responsive, or is there an aggressive review? In the case of that government agency, I would think, as in a case of yours, you ought to run the employee tapes against the tapes that show where the cash came from and see if there's a match anywhere.

Mr. DOLAN. We do have a very aggressive program in that arena. I think, again, I probably do not do that program service by my quick answers, but we would certainly be happy to give you a fuller

understanding of how it works. Also, I think you would be impressed with the number of cases that do generate from systematic examination of that data.

Mr. HORN. OK. We'll let that one go at that. Let me move to the underground economy, another thing that has long upset me.

What is our estimate of the underground economy that goes on in this country, and what, if anything, are we doing to try and get at that economy that pays not a dime of taxes except sales tax, possibly?

Mr. DOLAN. Well, where we have the confidence they are paying sales tax, that is at least a lead for us. Quite frankly, that is a big part of this. I broke down some of those—I said earlier, some of the characteristics of the less compliant folks were in businesses that did not have their income or their expenses or deductions matched by paper.

There is a subset of that that is euphemistically called the informal or, in your words, the underground economy. Probably the most effective technique we have found to date is our collaboration with States where we can, in fact, use the matching of our information and the State's information.

Typically—and the State of California is one where we have had a huge amount of success because of the work done within that State administration to enforce the sales tax—what we look for is crossmatches and look for aberrations between the Federal and the State taxing authorities to make sure that the people who belong on both sides of the rolls are there.

That, so far, has been the most productive, systematic way of doing it. Then the rest of it requires the hard work of street-level investigation.

Mr. HORN. If we got a profile of the typical industries that are more likely to be in an underground economy—in the case of southern California, we look around at people who are doing roofing, doing gardening, et cetera, a lot of that is with very low-skilled, perhaps illegal labor. What do you find?

Mr. DOLAN. We have attempted, as I mentioned earlier, to break that down into industry groups. We have, for example, considered the construction industry, and subsets of that industry. You have a variety of industries that would probably be clear to many of us in this room, people who do the kinds of business that typically requests payments in cash.

Without trying to target a particular subset of that, suffice to say there is a very substantial slice of commerce that is going on in that kind of cash-based environment, and it does not isolate to one or two occupations or one or two industries.

Mr. HORN. Let me move to student loans and any type of government loan that is owed the government. I remember a former university president who walked these halls to get student aid, how a case on 60 Minutes of a U.C. Berkeley graduate in dentistry who took great pride in not paying back his \$60,000 set us back around here for years.

What are we doing to assure some compliance of those loans made by the government being effectively recouped? Is IRS recommending anything to Congress in the areas where we do not have compliance, in terms of collection through your mechanism?

Ms. RICHARDSON. Mr. Dolan might tell you what we are doing right now.

Then, also, with the expansion of the student loan program last year, we may have an even more active involvement, along with the Treasury Department and with the Department of Education. We were asked to report to Congress on what the feasibility was of having the Internal Revenue Service involved in all phases of the collection process of that student loan program. We are currently and very actively working on that study.

We do have current capabilities to offset debt that is owed to the Federal Government, particularly in the student loan area. If a taxpayer had a refund due, we would offset the loan balance against that refund. But if that person did not have a refund or had a balance due, we would not be in a position to do anything, currently. In other words, we have no active collection efforts. Our role today is limited to offsets.

Mr. HORN. Well, are you planning to recommend a more active program, and do you need legislation to do it? One of our problems in the past has been, when I've discussed this with members of the Postsecondary Education Committee years ago, is, they do not want to lose jurisdiction to the House Ways and Means Committee because of your collection.

I realize we have a lot of turf problems around this place, but I would hope an agreement could be worked out that the policy is still set by the Committee on Education and Labor and we get the cooperation of Ways and Means for the authorization to have you do the collecting.

Ms. RICHARDSON. I think it is not really confined just to the student loan area. I think there is an active discussion underway, certainly in the Treasury Department and other departments, about the whole question of Federal debt collection and how it should be handled, which agency can best do it, whether or not, as you suggested, perhaps the substantive department should set the guidelines but have a debt collection body, agency, or something like that.

Mr. HORN. What is our estimate of uncollected debts due to any type of Federal loan?

Ms. RICHARDSON. I think we would have to get that information for you. I do not know. In the student loan area, obviously, the Department of Education has that information.

Mr. HORN. Could we get that and file it for the record, Mr. Chairman?

Ms. RICHARDSON. Yes, we certainly could.

Mr. SPRATT. Certainly.

Ms. RICHARDSON. We may have to rely on other departments to get that for you, but we will certainly try.

Mr. HORN. I'd just like to know, are we talking \$100 billion that is out there that should have been collected and hasn't been collected?

Ms. RICHARDSON. I would be reluctant to speculate. I do not know. I do recall, in looking at some of the education figures, the amounts were much lower than I think people had been discussing at one time.

[The information referred to follows:]

IRS does not have information on the amount of uncollected debt due to Federal loans. In its refund offset program, IRS reduces tax refunds of taxpayers who have defaulted on debt to Federal agencies. Each year the agencies certify defaulted debt and refer it to IRS. IRS matches the entity information (name, address, TIN) against its masterfile and then reports back to the agencies on the matches. The following table is a portion of a report prepared by Financial Management Services on the number of accounts which matched with IRS' masterfile and the total masterfile and the total outstanding debt on those accounts.

Calendar Year 1994 Tax Refund Offset Program Workload

Agency	Accounts Matched to IRS Masterfile for Offset		
	Number of Accounts	Amount of Outstanding Debt	Average Debt
Agriculture	20,064	\$770,803,559	\$38,417
Defense	177,009	\$220,722,662	\$1,247
Education	2,972,090	\$11,133,968,059	\$3,746
HHS	3,999	\$101,487,091	\$25,378
HUD	38,015	\$327,869,838	\$8,625
Justice	37,281	\$1,100,532,942	\$29,520
SBA	12,133	\$185,017,366	\$15,249
Public Debt	1,343	\$426,425	\$318
VA	193,957	\$323,348,046	\$1,667
Energy	53	\$37,872	\$715
Customs	1,973	\$549,837,976	\$278,681
Interior	767	\$13,258,376	\$17,286
RRB	5,852	\$9,388,661	\$1,604
DOT	2,031	\$3,544,578	\$1,745
State	1,316	\$1,334,378	\$1,014
SSA	57,352	\$118,515,272	\$2,066
FNS	187,607	\$100,689,893	\$537
SS	2	\$2,213	\$1,107
OPM	260	\$1,559,965	\$6,000
Peace Corps	1	\$448	\$448
FEMA	38	\$93,882	\$2,471
* ATF	6	\$1,645	\$274
* Commerce	5	\$33,675	\$6,735
* EEOC	23	\$20,475	\$890
* EPA	15	\$51,050	\$3,403
* GSA	79	\$105,259	\$1,332
* USIA	16	\$19,089	\$1,193
* SEC	11	\$8,255	\$750
* NSF	22	\$7,782	\$354
Totals	3,713,320	\$14,962,686,732	\$4,029

Source: Asset Management Group, Financial Management Service

* Represents referrals for cross-serviced agencies

Tax Refund Offset Program Collections

<u>Calendar Year</u>	<u>Number of Accounts</u>	<u>Amount Collected</u>
1993	1,758,162	\$1.19 Billion
Jan-May 1994	1,864,350	\$1.3 Billion

Mr. HORN. Moving to another question, which has to do with identification numbers, employer identification numbers. I was delighted to see the President advocated a counterfeit-proof Social Security card. When I was vice chairman of the U.S. Commission on Civil Rights, I advocated it in 1980, and I have been frustrated that presidents, regardless of party, seem to have done nothing about it until now, and I hope this president does something about it.

As I understand it, we have millions of dollars being defrauded, not only from IRS, but from medical insurance companies. Another subcommittee of the Committee on Government Operations has investigated Medicare/Medicaid fraud. And it's partly because IRS issues multiple employer identification numbers to doctors and pharmacists who apply for them under different names.

Now, what is the policy of IRS in this regard? Is there a way to get at this abuse? Is there cooperation with the Social Security Administration on agreeing on a number which might well be the Social Security number? What's happening?

Mr. DOLAN. Obviously, our policy is not to issue somebody who changes names on us multiple employer identification numbers. Some of that does happen.

One of the places, I think, where we are going to be well served, again, by Tax Systems Modernization is by—right now, when you are issued an employer identification number, that carries with it some predictive characteristics, as far as we are concerned, in terms of what business you said you were going to be in, that ought to predict whether you are going to have employees or not, what are your employment filing requirements or other kinds of returns.

Given an environment in which we can make an accelerated contact, meaning the first quarter after the request for the employer identification number, we ought to be able to ferret out much more rapidly, than we can today, where it might be three, four, or seven quarters later before a contact is made. That's one of our principal ways of dealing with people who are trying to beat the system.

On the Social Security side, we have had very active discussion with the Social Security Administration on trying to align the way we manage the employer identification number process with the way they manage. Quite frankly, we probably have as much reliance on the Social Security numbering system as does Social Security. We are in an almost constant dialog with Social Security about how our two systems interact and how we can improve each other's capabilities.

Mr. HORN. Is there a problem in terms of the interaction due to their lack of modernization?

Mr. DOLAN. No, I do not want to speak for their needs or lack of possession of modernization. I would say that we have found them a very active partner on the issue, particularly as we have attempted to deal with the issues of fraud, as it pertains to our two agencies. So they have been very aggressive and very active partners.

Mr. HORN. Two last questions, Mr. Chairman. The last one will be on modernization. I can't help but mention charitable donations, since a number of people in the arts and cultural areas have expressed concern. I guess the issue made the headlines not too long

ago when the President and Mrs. Clinton gave various donations of suits, socks, and so forth, to charitable organizations.

How do we deal with that? Is there a limit IRS has on the value one can claim for a specific item, like a suit or a shirt? I realize, if it's Marilyn Monroe's suit or shirt, or Mae West, or maybe the White House, that's far different from some local person just getting rid of what's in the closet. But how do you figure that? Is there a value added for celebrities?

Ms. RICHARDSON. Taxpayers are entitled to a deduction for the fair market value of the property that they give to the charity. People sometimes have items appraised and submit an appraisal slip with the donation. But it is typically the fair market value that is deductible. As you know, fair market value is really determined by what a willing buyer will pay and a willing seller will sell for.

There is no one mechanism for making that determination. It depends on all the facts and circumstances. But we have certainly no limits on specific items.

Mr. HORN. There is no question that a type of charity action supports a substantial amount of American culture, American voluntary organizations, be it the cancer fund or the heart fund, or whatever. I just wondered what the IRS reaction is to that. Is there any special targeting one way or the other?

Ms. RICHARDSON. Well, there were some new reporting requirements that came in OBRA 1993 that required of charities if you donate property in excess of \$250, the charity will actually have to give a statement to the contributor as to the valuation. So the rules have changed a bit for this year.

But, by and large, it is up to the taxpayer to determine what the fair market value is, and if we audited the taxpayer, we would take a look and make a decision whether we agreed with the valuation or not.

We have, also, an art advisory panel that, for donations of art works and things, frequently gets involved in valuations, too.

Mr. HORN. Last question: Control agencies, in this case OMB, possibly GSA, often expect quite a bit of pints of personnel blood when an agency undergoes modernization, feeling there has to be a tradeoff in savings or positions, if we modernize, et cetera.

What kind of pressure are you under from the Federal control agencies because of this modernization effort? Do they expect you to cut your full-time employment equivalents by so many thousand, or is there a phasing of it that makes realistic sense? What kind of a gun are you under here?

Ms. RICHARDSON. I think the fiscal year 1995 budget, and particularly with our compliance initiative, indicates that we do expect to have some productivity savings. But we are also—and I think this administration has realized that stripping the IRS in order to realize a productivity savings and not invest in compliance is not a wise business decision. So I think the 1995 budget really does us a great service, and if we are able to get our request, I think we would be in good shape to start really working even more diligently on the compliance concerns.

I think each and every one of us is cognizant that these are difficult times, there is a lot of competition for Federal budget dollars, and that you, as an oversight committee, and our Appropriations

Committee have a right to expect that we will account for our resources and use them wisely.

So I do not think, merely because we are the Internal Revenue Service, we should be entitled to all the budget support we ask for. On the other hand, I think we do have an unprecedented opportunity to make a difference in compliance. I do think that we can take our productivity savings and reinvest it with many of the people who are on board. Our personnel are already trained, at least in large part, to do some of the things, or can be easily retrained to do some of the things that need to be done.

I think that one of the reasons that the compliance problem has not really been addressed as well as it might have been in the last few years is, we have not had the stability of funding that we have needed to do some of the things we wanted to do. The last real compliance initiative that we had and had funded was in fiscal year 1991. Since that time, we have actually reduced our staffing over 3,000 FTE's, actually a little bit more than that. Just in our compliance staff, we have reduced over 3,000 FTE's.

So our fiscal year 1995 budget is really an attempt to get us back on track and try to do something that is not just totally productivity driven. Productivity is clearly important, and we have to continue finding ways to do our business more efficiently, but I think we can do something with those people that can make a serious and important difference for the American taxpayer.

Mr. HORN. What did you ask the Attorney General for, or were you here when that decision was made for the budget for fiscal 1995 that is before the Congress now? What employee level did you ask for, compared to what did the Attorney General recommend, compared to what did the President or OMB give you?

Ms. RICHARDSON. I'm sorry. The Secretary of the Treasury?

Mr. HORN. I am sorry. The Secretary of the Treasury.

Ms. RICHARDSON. I guess our base budget is currently about 112,000 FTE's in our operating plan. The base budget for fiscal year 1995 is around 109,000. With the additional compliance initiative of about 5,000 FTE's, we would be about 2,000 FTE's ahead of where we are today. So we would be at 114,000 plus, whereas today we are at about 112,400 something.

Mr. HORN. Did you ask for that, and did you get that?

Ms. RICHARDSON. Yes.

Mr. HORN. Before I said the Attorney General. The reason I said it is, in my mind it is the cuts that have occurred in INS, the Immigration and Naturalization Service, which I have grave concerns about. And I wondered if, in your agency, Treasury, you have been treated similarly.

Ms. RICHARDSON. No. Indeed, I think we have been very well supported. Secretary Bentsen has been a very staunch supporter of ours. In fact, I think he is testifying before the House Appropriations Committee today in support of our budget requests. We were not able, within the budget caps that were allocated, to fund all of our initiatives. But if we get the compliance initiative that we are asking for, we would actually be ahead of where we are today—and significantly ahead.

The other important thing to remember, which makes a significant difference in the way we are able to run our business, is that

this is the first time we have had a fully funded labor base since 1991. Every other year we have come in with an unfunded labor base, which has meant, although it appeared that we were getting a certain FTE level, we were really not able to fund it. So we have taken significant cuts and have never been able to make good on our desires to have compliance initiatives.

So this is the first time in several years that we have a fully funded budget, and truly there is no smoke and mirrors here. What we have asked for is what we can use, and it is fully funded.

Mr. HORN. I would like, Mr. Chairman, if the Commissioner could file at this point, for the record, a fuller statement on where those losses occurred since 1991 and where you weren't able to carry out certain things you felt were essential to tax collection.

[The information referred to follows:]

Due to differences with OMB on IRS labor costs, congressional budget cuts, and legislation approved after the budget cycle, we have been unable to fully fund a number of important compliance initiatives over the past few years. For example:

. In FY 1992, \$90 million in unfunded labor costs had to be accommodated in that year's budget

. In FY 1993, we had a \$210 million shortfall. We solved it by redirecting \$130 million in support resources to labor costs and reducing FTEs by 2000 to handle the balance of the shortfall.

. In FY 1994 after negotiating with OMB we were able to add \$40 million to unfunded labor, but that still left us with 1600 FTE's not realized.

. In FY 1995, all labor costs are funded within the base and we will not have to redirect resources unless Congress approves pay increases beyond what is budgeted.

Mr. HORN. Because, apparently, you are saying that, even with the budget caps now, you have the flexibility to move personnel around through retraining that you will gain under the modernization program, some personnel slots, can you move them into the areas where you feel you have been shortchanged over the last few years?

Ms. RICHARDSON. If we are able to get the full funding for the compliance initiative, the answer to that question is most definitely yes.

Mr. HORN. Well, since I agree with Mr. Justice Holmes that taxes are the price we pay for civilization, I hope you get the full funding.

Ms. RICHARDSON. We would like to stay civilized, I assure you.

Mr. SPRATT. Thank you, Mr. Horn.

There are several indicators of whether we have an effective, efficient tax collection system. One of them is the so-called tax gap, and while this is a somewhat conjectural number, I've seen numbers that are almost over the lot. The NTEU uses \$120 billion as its estimate of the gap. I've seen \$180 billion. Does the Service have an official estimate of the tax gap, the difference between taxes that ought to be paid and taxes that are actually filed and acknowledged?

Ms. RICHARDSON. I think the answer to that is that our \$7 billion to \$10 billion estimate of what each percentage in the compliance level could yield is based on the gross amount of \$150 to \$170 billion.

Mr. SPRATT. Seventeen percent, so that's 17 percent of what base amount?

Ms. RICHARDSON. What we anticipate is probably a gross number of around \$150 to \$170 billion. I would not be telling you the truth if I told you I thought that you could measure any of it with complete precision. We, through our compliance efforts, are able to collect almost \$40 billion of that annually. So we are really somewhere in the \$110 to \$130 billion range, is our net tax gap. I would say an excess of \$110 billion, as you and your subcommittee have indicated, is probably as accurate as we can be.

Mr. SPRATT. So the tax gap is around \$170 billion with allowance for—

Ms. RICHARDSON. As I say, that's a gross number. I think your \$110 billion is probably just as accurate.

Mr. SPRATT. \$110 billion would be after collection efforts.

Ms. RICHARDSON. Yes.

Mr. SPRATT. What is the number of your receivables today, number of accounts, not the dollar value but the actual number of accounts? And what has been the experience with the number of receivable accounts over the last 5 years?

Mr. DOLAN. I could have answered the question before you clarified it. Can I get you that for the record?

Mr. SPRATT. Sure. It would be nice to measure it against the fiscal year 1991 baseline, just to see what has happened since those initiatives were taken.

Ms. RICHARDSON. We can track the fiscal year 1991 compliance initiative through this year and tell you how much it has yielded

and how much we anticipated. And we can do that with a great deal of precision.

Mr. SPRATT. Just by itself, what's the number of receivable accounts today?

Mr. DOLAN. Can I supply that?

[The information referred to follows:]

These figures represent the total accounts receivable inventory, including both current and noncurrent (i.e., the noncurrent portion of estate installment agreements) as reported on the Service's REPORT ON ACCOUNTS AND LOANS RECEIVABLE DUE FROM THE PUBLIC as of September 30 each year:

1989	12,636,764
1990	12,867,641
1991	14,281,502
1992	15,096,320
1993	17,249,480
1994 (1st qtr, as of 12/31/93)	16,801,949

Mr. SPRATT. Certainly. How about nonfilers? There's a number here that is used by senior counsel, Richard Peterson, 10 million. And the GAO says that in 1993 alone, since we changed the withholding tables, we found that a lot of people file tax returns not to pay taxes but to get refunds.

With the withholding tables changed and refunds diminishing, as many as 2 million taxpayers fewer than last year have filed returns in the current year. Is this correct?

Ms. RICHARDSON. It is. We have 2 million fewer filers than last year, the 1992 tax year.

Mr. SPRATT. Is that a cause of concern, or do you figure that most of these people do not owe any taxes?

Ms. RICHARDSON. What we are doing is really attempting to analyze exactly what that 2 million represents, but it is obviously a cause for concern. Some people did not need to file returns, and I think that several years ago a concerted effort was made to notify people who, for whatever reason, did not need to file returns that they did not need to do so.

I think some of that 2 million clearly relates to that. Another portion of it I think we feel very confident relates to the fact that people discovered, probably closer to April 15 last year, that they had a balance due and perhaps did not have the money and were concerned about filing. We made a significant effort to try to let people know that they could file, that they did not have to pay in full, they could, in effect, apply for an installment agreement and automatically go on it, in some situations, and we tried to make that process quite easy.

But we were still about 2 million returns short. As we get more information about what really caused it or what that 2 million is comprised of, we will be happy to share it with this committee.

[The information referred to follows:]

Cumulative return receipts, which were down by about 2 million from last year as of February 25, 1994, were only about one million below last year's level as of April 1, 1994. The gap continued to narrow throughout the rest of the filing period, and we ended up with a growth of 609,000 returns over last year (As of June 3, 1994).

We have asked the Service's Research Division to explore reasons for the change in filing patterns from 1992 to 1993 and to review the original projections for the volume of returns to be filed this year. At this point, there appears to be three factors that played a role in the decline.

First, tax year 1992 saw an unprecedented drop in interest rates (and interest income) from prior years, which may have pushed some filers below the filing requirement threshold. Interest rates held steady at these lower rates during 1993, leaving little opportunity for growth in interest income. The absence of this growth in 1993 may also have kept some taxpayers from reaching the income threshold at which they would be required to file.

Secondly, this year the Service sent about 1.4 million notices to taxpayers who filed returns, but had no need to do so. This is about 400,000 more notices than were sent out last year, and the resulting reduction in the number of unnecessary filings should have a moderating effect on growth in overall returns filed.

Finally, we continued to see a residual effect of late filing in Tax Year 1993 from the change in withholding rates that occurred during 1992. Tax year 1993 reflects the first full year under the lowered withholding rates. In Tax Year 1992, these rates were only in effect after March 1, or later, if the employer was late in switching over to them.

Mr. SPRATT. Well, it would be interesting to know that, but that would be an indicator, you would agree, of efficiency and effectiveness of the tax system, getting everyone who is supposed to file a return to actually file one.

Ms. RICHARDSON. Absolutely. And our goal is to assure that everyone, who is obligated to file, files, and not only that, that everybody pays his or her proper share of their taxes. And I think we want to underscore "proper." We do not want any more than we are entitled to, but we certainly want to collect what we are entitled to.

I hear from many, many taxpayers who laud our efforts to focus on compliance, because I think they are very concerned, as Mr. Horn suggested, that somehow they are being put at a competitive disadvantage, if they are in business. They are paying their proper share of taxes, and they are being put at a competitive disadvantage by their neighbors or their competitors who are not paying their proper share.

So we view this as a very serious issue and one that we are trying to address in a number of different ways.

Mr. SPRATT. Is 10 million a good number or an approximation of how many Americans aren't filing tax return who ought to be filing returns?

Mr. DOLAN. It is, as far as our compliance research has taken us to date.

Mr. SPRATT. And that's out of a total population of how many taxpayers who file returns?

Mr. DOLAN. Well, it's out of a base of roughly 200 million filings. I can break it down for you, with more specificity on both the business and the individual side, and maybe put the 10 million in that context, if you would like.

Ms. RICHARDSON. The 10 million is comprised of both business and individuals.

Mr. SPRATT. Right. So you have some multiple taxpayers.

Ms. RICHARDSON. Yes. We could give you some more specific information.

[The information referred to follows:]

The general number of 10 million nonfilers can be broken out as 7.5 million individual and 2.5 million business nonfilers.

Mr. SPRATT. What about in the area of document matching? I know that has been an elusive goal of the Service. You've found it not as easy as one would think, just thinking about how it should be done. Do you think you're getting any better at crossmatching documents and detecting unreported income or underreported income by using Form 1099?

Ms. RICHARDSON. I think one of the things—and Mr. Westfall can speak to this more specifically—the Tax Systems Modernization is going to do for us, and actually has been doing for us, is to allow us to match much more currently and give us the opportunity to get to people much sooner.

Mr. SPRATT. Well, that was my next question. Is the hardware and software you are about to bring online going to enhance your ability to do crossmatching?

Ms. RICHARDSON. Most definitely.

Larry, you might talk a little bit about that.

Mr. WESTFALL. Mr. Chairman, I think I can help with that. We have an automated underreported system that we have already put in place. We have implemented it in four locations, and we have two other locations that will be implemented within the next 2 to 3 months. That system basically automates the previously manual process of our doing a match and then communicating with taxpayers relative to discrepancies on their return.

The automated underreporter system has proven to be invaluable, in terms of reducing the errors in the system, enabling us to communicate with taxpayers earlier relative to match discrepancies, and also just to improve the quality of what we are doing. Our old system was very, very paper burdensome, difficult to work with, and paper makes for mistakes.

So, in the short term, TSM has helped us a lot. It has also brought about a 10-percent productivity improvement to that operation because of the computer assistance that it gives to the examiner doing the match. But that's the short term.

In the longer term, Tax Systems Modernization brings an enormous improvement to the match process by bringing the posting of the matched documents to our master file before a return settles. We envision, upon implementation of the total set of systems changes that we will put in place over the next several years, we will get to a point where we will actually have information on interest and dividends in the taxpayer's account before the return is filed. So instead of it being 2 years after the fact when we do that match, which is about what it is today——

Mr. SPRATT. It will be waiting when he files his return.

Mr. WESTFALL. It will be there when the return settles, and instantly we will communicate with the taxpayer relative to a mismatch. Those kinds of things, very, very early and very, very complete transactions, are what will help us more with compliance in the future than almost anything else. It certainly provides a stage from which we can move forward with other compliance methods.

Mr. SPRATT. Mr. Horn asked you about real estate transactions. One of the changes in the law in 1991 was to require—it might have been earlier—but, in any event, a recent change in the law was to require filing, at closing of the transaction, pertinent data regarding the transaction. Do you have any sort of capsulized summary of how effective this particular measure has been in collecting taxes due on real estate transactions?

Mr. DOLAN. I do not have that at my fingertips, but we can supply it to you. We do individual studies around those various matching programs.

[The information referred to follows:]

Section 6045(e) of the Internal Revenue Code of 1986 requires that an information return is required to be filed in the case of Real Estate transactions. This law applies to real estate transactions closing after December 31, 1986.

The latest year for which statistical data is available for the Underreporter Program is tax year 1990. For tax year 1990 2,968,000 information returns (Form 1099S) were filed to report real estate transactions. Of these 30,452 cases were worked in the Underreporter Program. (CP2000 notices were sent to these taxpayers.) The additional tax assessments totaled \$13,591,132.

Mr. SPRATT. Has it been significantly effective, or are you finding transactions that probably wouldn't have been reported in the past?

Mr. DOLAN. Yes, both with respect to initial matching, but also in the context of examination.

Mr. SPRATT. I think that information would be helpful, because it's an illustration of a particularly new system of reporting that didn't exist in the past. If you could not show some significant increment of income taxes as a result, it would allow some inferences about what taxpayer compliance measures can do.

Looking at all these things—going back to fiscal year 1991, do you have an estimate at your fingertips, or one you can provide for the record, of how much revenues have been collected due to the taxpayer initiative, compliance initiative that was part of the Budget Enforcement Act of 1991? Do you have a dollar amount that you can attribute to that initiative?

Ms. RICHARDSON. We do, Mr. Chairman. I guess the overall amount is in the \$13 billion range that is attributable to that initiative.

Mr. SPRATT. Through fiscal year 1993?

Ms. RICHARDSON. Through 1993; correct.

Mr. SPRATT. \$13 billion.

Ms. RICHARDSON. Right. And we are currently in 1994. So you can see, we feel it was a good investment then, and that is why we think our \$405 million initiative would be a good investment today.

Mr. SPRATT. It may be in your testimony. I didn't see it. Could you give us a breakout of that?

Ms. RICHARDSON. We certainly can. And I would be happy to submit for the record exactly how we spent the money and where the revenues have come in.

[The information referred to follows:]

FY 1991 Compliance Initiatives Summary

(\$ in Billions)

As of December 31, 1993

	FY 1994			FY 1991 - 1995		
	Congressional Budget Targets	Current Projections	Actuals To-Date	Commissioner's Commitment	Congressional Budget Goals	Current Projections
Management Initiatives:						
Counsel/Appeals Large Case	N/A	N/A	N/A	\$1,000	\$1,000	\$3,468
Employee Plan Actuarial Examination	\$0,027	N/A	N/A	\$0,802	\$0,738	\$0,073
Examination Tax Shelter	N/A	N/A	N/A	\$0,737	\$0,673	\$0,673
Coordinated Examination Program (CEP)	\$0,384	\$1,575	\$0,333	\$0,967	\$0,967	\$4,951
Examination Excise Tax	\$0,033	\$0,127	\$0,028	\$0,147	\$0,147	\$0,272
Resource Initiatives:						
Collection Accounts Receivable	\$0,282	\$0,245	\$0,054	\$1,608	\$1,114	\$1,040
Collection Delinquent Returns	\$0,650	\$0,578	\$0,134	N/A	\$2,768	\$2,017
Examination Field Audit	\$0,188	\$0,312	\$0,070	\$1,082	\$0,819	\$0,832
Examination Training	\$0,092	\$0,046	\$0,011	\$0,517	\$0,492	\$0,178
Examination Claims Audit	\$0,159	\$0,213	\$0,024	N/A	\$0,876	\$0,635
RPA Dependent SSN Matching	\$0,054	\$0,013	\$0,004	\$0,939	\$0,257	\$0,045
RPA Mortgage Interest Credit	\$0,013	N/A	N/A	\$0,144	\$0,084	\$0,003
RPA Non-Cust. Parent Opt.	N/A	N/A	N/A	\$1,018	N/A	N/A
Examination Service Center	N/A	N/A	N/A	\$1,037	N/A	N/A
GRAND TOTAL	\$1,870	\$3,106	\$0,660	\$9,398	\$9,778	\$14,419
						\$14,272

1. Counsel/Appeals Large Case, a one year initiative, was the most successful initiative in FY 1991 recovering nearly \$2.5 billion over the \$1.0 billion target.
2. RPA Non-Custodial Parent Dependent and Examination Service Center were two of the original FY 1991 Compliance Initiatives. They were subsequently removed and replaced by the Collection Delinquent Returns and Examination Claims Audit initiatives.

Mr. SPRATT. Now, as I look at your budget this year, and as I look at Mr. Tobias' testimony, which is coming next, there are some significant decreases in manpower, personnel, and in some significant areas of the Service.

Taxpayer services, which was a large part of your testimony, obviously, the Service wants to enhance the services you are rendering; you want to make them more efficient by using better data processing. But you acknowledge that getting good responses over the telephone may be a large part of the solution, just getting an answer the first time you call and not being referred multiple places. Getting an authoritative response may be a large part of getting taxpayers to work more cooperatively with and appreciate the IRS better.

Taxpayer services is going down 249 people between 1994 and 1995, and between 1993 and 1995, it will go down 631 people. Can we assume that TSM is really going to generate that kind of productivity so we can dispense with these people and still get the answers that taxpayers want when they call on the telephone, still get the telephone answered, indeed?

Mr. DOLAN. Can we make this a two-headed response?

Mr. SPRATT. OK.

Mr. DOLAN. I think, in the short run, what I am going to ask Larry Westfall to do is talk about some of the here and now precursors of where Tax Systems Modernization will take us on the telephones.

What we have done, though, in today's environment, notwithstanding those kinds of decreases in staff power applied to the business of taxpayer services, we have attempted to maximize, within today's suite of equipment, our resources in such a way that, notwithstanding that downward step in people, we are actually, at this time this year, answering a half million more telephone calls in the filing season than we did this time last year.

So, between the introduction of the technology and the emphasis on both quality and management of time and gating the traffic, I think we have made up, to some extent, some of the shortfalls in staffing by increased efficiency. That does not get it for the long haul. I think the long haul answer, Mr. Westfall may be able to share some dimensions of our customer service strategy.

Mr. WESTFALL. To begin with, historically, the great majority of our telephone activity has been focused on taxpayer assistance, answering questions, dealing with account-related issues. Under the customer service vision for the future, we would envision customer service being the first step in ensuring voluntary compliance.

As I mentioned earlier, the earlier posting of accounts and the significant, unprecedented use of the telephone by IRS in dealing with the taxpaying public very quickly after events take place, will have more impact on voluntary compliance than almost anything else we do.

What we have begun to do already in installing technology is put more automated equipment in our telephone sites than we have had in the past. And that is significant productivity improvements and also quality improvements in what our assisters are able to do.

There are several reasons for this: No. 1, we are beginning to use the voice response units, our routing units, on the front end of the

systems. We have them in about half of our telephone locations today. They enable people to get into the system and, through interacting with the system, get gated and routed down to specialty areas where they can get assistance, either getting into the TeleTax system, where they can get automated assistance, or dropping out to a real assister and getting access to someone who is as fully prepared to deal with them in a specialty of law, like depreciation. Taxpayers are routing themselves through these automated routing devices.

These devices are proving to be, in the locations where we have them, very effective in getting more taxpayers in, more taxpayers served, and improving the quality of what we do.

We have also made a significant amount of additional information available to assisters already through what information systems has been able to do with our existing file structures. So we have very, very significantly, by 31 percent this year, increased the number of one-stop or online closures that we have been able to accomplish with a taxpayer who calls in.

In other words, a taxpayer calls in and has a problem, we can take care of that problem through the information available. The assister can then deal with the issue, answer the question, close it out without followup, having to refer the taxpayer to an additional point in the system, all of those kinds of things.

So we have begun to make significant changes in our telephone operations already, beginning to blend, beginning to bring information in, beginning to use more and more technology, and we will move very, very aggressively to continue that over the next several years, moving toward the full customer service environment.

Mr. SPRATT. The other areas are even more significant than that. Returns processing, if you look at fiscal year 1993 as compared to fiscal year 1995, you lose 4,022 billets, 4,022 service agents in returns processing. Now, we've already noted we have problems with nonfilers that have increased 2 million returns in 1 year. Is this automation—can we free up this many positions alone and still have the kind of vigilance we need in pursuing those who aren't filing the returns they are supposed to file?

Mr. DOLAN. This is a very dangerous question to answer with the Chief of Taxpayer Services sitting at my back, because I think what Judy has done, and what that organization has done—returns processing is the place from which much of the early Tax Systems Modernization productivity has been harvested. And much of that has been harvested in step with the automation that has come in; some of it has been harvested, quite frankly, ahead of the full yield on the TSM initiatives.

What we have done is, I think, a masterful job of staying in touch where the workload is increasing. And that is a good indicator, when the workload increases, in terms of returns coming at you. But, I think, through a number of modernization initiatives and, quite frankly, through some management improvement, we are able to hold our own. It is not a place where we can take any kind of appreciable broadsides, though, and still get the tasks of a filing season done.

Mr. SPRATT. So we are cutting to the margin, then?

Mr. DOLAN. We are at a point where we can not handle any unforeseen external events or we would be in trouble, in a filing season.

Mr. SPRATT. Examination, there's 3,621, just about as significant a number. I think the figure I've seen is, about 1.03 percent audits of returns being filed?

Mr. DOLAN. I think this year's examination rate will be about 1.5. That is, in large part, a function of the additional units of work that have been put in in the nonfiler arena.

I think you're looking at the 1993 to 1995 shift in examination. That does not all come out of the revenue agent category. What we have attempted to do there, in the support and other categories, is take as significant a proportion of that cut as we could, so as to not affect the tax examiner, the tax auditor, and the revenue agent. But all three of those occupations have indeed had some diminishment in the 1993 to 1995 environment.

Mr. SPRATT. Would you agree that you're cutting to the margin there?

Mr. DOLAN. Well, I think that's probably—cutting to the margin is maybe a charitable way of saying it. I think, in the context of the discussion we were having earlier about what we think we know about the noncompliance, there are some huge opportunities out there that—

Mr. SPRATT. If we had more examinations, we would find more nonreported income.

Mr. DOLAN. Absolutely.

Ms. RICHARDSON. I think you have touched on exactly why it is so important to have that compliance initiative fully funded for next year, because I think it will allow us, for the first time, to put more people in some of these compliance positions, not just in examination, but in the international area and the criminal tax area, so that we can make a significant difference in the compliance levels.

Mr. SPRATT. Now, in the area of international, I'm not sure what that is, but President Clinton made a big pitch during his campaign for collecting some of the taxes that multinational firms allegedly do not pay when they do business in this country. And I think we all know that that's easier said than done. It is sophisticated area of tax enforcement as well as tax law. Yet we are cutting 209 people. Is that a classic case of being penny wise and pound foolish?

Ms. RICHARDSON. Again, with the compliance initiative, that would not be the result. That is, again, why we are very anxious to have it supported, because we would agree with you, it would be penny wise and pound foolish.

We now have an international program that is in a position to really yield significant compliance results. We have what we call our advance pricing agreement program, where we are bringing companies in ahead of time and working out, in the transfer pricing area, working out methodologies, so we do not have to expend audit resources, examiner resources, and ultimately litigate issues. It also provides taxpayers with the certainty they need to conduct their business. It accelerates the revenues coming into the Treasury.

This is a program that we would not want to cut back on at all; our compliance initiative would allow us to expand that program.

Mr. SPRATT. In the area of collection, there's 2,132 FTE's. Now, I think we would all agree that collections is sort of like examination. In the case of collection, you've found the money due and payable, but my experience with working with your own agents and taxpayers who have delinquent accounts is, it's a very labor-intensive process.

You have to go examine their assets, find what is liquidatable and what isn't, and make business decisions about whether or not you want to come down hard or back off and allow the taxpayer to try to work his way out of it. And there's no substitute for having people there. You can't automate this process easily.

Ms. RICHARDSON. That is correct.

Mr. SPRATT. Given a \$60 plus billion accounts receivable that we seem to be unable to work down to a lower level, does it make sense to knock 2,132 people out of collections?

Ms. RICHARDSON. No, we do not think so. Again, our compliance initiative would allow us not to have to do that.

Mr. SPRATT. And document matching, I guess that is 635 there, at least you can say we have a computer that will enhance the—

Ms. RICHARDSON. That's certainly going to help, but, again, once those documents are matched, we have to do some followup with the taxpayers in order to make that compliance program effective. So it is extremely important, as I think you pointed out, not to rely solely on the technology. We do have to have people to run these programs.

Mr. SPRATT. In my own experience—and I think if we had an open mike in the room, everybody in the room would have anecdotes to tell about their experiences with the Internal Revenue Service—is that when you allegedly find a document that is crossmatched and underreported, but it's a mistake, you have a hell of a time explaining to the service center that this is a mistake, a genuine mistake. This was reported, or this was included, or this is the wrong ID number, whatever it may be.

That's where people come in. You have to have somebody making the data entry who can read it, acknowledge that this taxpayer is correct, and dispose of it and get on with something more fruitful.

Ms. RICHARDSON. Absolutely. And I think this is probably the one area where many, many taxpayers can identify with the benefits that Tax Systems Modernization is going to provide us, and that is online information, so when someone does call and says, for example, "I did report that; I had it on line 9 instead of line 10," you can have a live person on the other end looking at that record and saying, "You're absolutely right; we will take care of it right now on the telephone," and that's the end of the process, instead of correspondence crossing in the mail, building frustrations on both sides.

So I think we clearly have to have the people, but that is also an area where the modernization efforts are going to help us considerably.

Mr. SPRATT. You have given Treasury an estimate, as I understand it, to the Office of Tax Analysis, of what total revenues can be recouped if the compliance program, the compliance initiative is

implemented, and it's a total of \$9.8 billion from fiscal 1995 through fiscal 1999. Does that include the cost? Is that net of the cost, or is that just gross return?

Ms. RICHARDSON. No, actually the gross number is \$9.2 billion. Actually, we have developed that number working with Treasury, but their Office of Tax Analysis has validated the number. That is not actually our number. I think we view that as a very conservative amount.

Mr. SPRATT. The cost is \$405 million a year times——

Ms. RICHARDSON. Five years.

Mr. SPRATT [continuing]. Five years, which is a little over \$2 billion.

Ms. RICHARDSON. That is correct.

Mr. SPRATT. So the net return is \$7 billion in that period of time, better than \$7 billion.

Ms. RICHARDSON. Correct—\$7.2 billion.

Mr. SPRATT. How do you baseline this amount? First of all, do you feel this is a valid estimate? Can you validate the estimate?

Ms. RICHARDSON. Yes, I think we can, and we will be happy to provide you and your staff with the backup. I think the people at the Office of Tax Analysis will be happy to, as well.

Mr. SPRATT. I think it would be very useful.

Ms. RICHARDSON. I think we feel that it is a conservative estimate, but we would prefer to be more conservative than not.

Mr. SPRATT. Now, if we wanted to baseline revenues today and identify this increment as it was realized over the years, so that we could comply with Director Panetta's feelings that this should not be simply charged up to increased benefits, it shouldn't be spent, it should be put on some kind of scorecard and charged to the deficit, we would pay the additional expense to the IRS and give you a dispensation from the budget cap for that reason, but otherwise we would charge any resulting gain to deficit reduction, how do we do that?

How do we baseline today's revenues and identify the increment that is being realized because of enhanced compliance measures?

Ms. RICHARDSON. Well, we have been able to track the last compliance initiative that we really had, which was our fiscal year 1991 initiative and I think have been able to indicate what kinds of revenues it has produced. We would anticipate doing the same thing for this initiative, although we have actually more sophisticated management information today, so I think we could give you much more precise information as we moved along.

I think each and every one of us sitting at this table and the senior management of the organization, as well as Mr. Tobias, with whom I have had conversations, are very committed to this, because I think we really do feel that we have to put money where our mouth is, if you will, and that we ought to be held accountable.

So we feel very strongly that we should be able to track this initiative, we want to be able to do it, and we plan to do that.

Mr. SPRATT. In submitting your validation for the \$9.8 billion estimate, could you also submit how it might be baselined and tracked over the next 5 year?

Ms. RICHARDSON. Absolutely. We will be happy to.

[The information referred to follows:]

<p>INVESTING IN TAX COMPLIANCE FY 1995 COMPLIANCE INITIATIVE</p>
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<p>OPPORTUNITY</p>

The Federal Budget deficit will be approximately \$170 billion in FY 1995. Through its current compliance programs, IRS collects about \$34 billion a year in taxes due but not reported or paid. We can do better.

Increasing investment in compliance programs can yield several times its cost and contribute to improved voluntary compliance. Compliance levels are at approximately 83%. Each one percent change in this level will generate up to \$10 billion in additional taxes each year.

<p>APPROACH</p>

Budget Accommodation - The Administration is working with the Congress on a budget approach that will permit funding of \$405 million in additional compliance programs in FY 1995. Tax revenues from these initiatives are estimated at between \$9 and \$10 billion over the FY 1995-FY 1999 period and will reduce projected budget deficits.

Good Business - The Internal Revenue Service is the principal profit center for the Federal Government, collects over 90% of all Federal receipts. On average, IRS compliance programs return \$5 for every \$1 spent. Stability in financing tax administration just makes good business sense.

Long Term - The FY 1995 initiative is a first step in a long-term strategy to improve voluntary compliance by investing streamlining and modernization savings in front-line compliance and customer service activities.

DELIVERY ON COMMITMENTS

For FY 1995, IRS is in an unprecedented position to make a compliance difference.

- For the first time, labor costs are fully funded. IRS and OMB have worked together to identify factors affecting IRS labor costs and funded FTE on mutually agreed projections.
- Actual results can be tracked. A new system for tracking enforcement revenue separately from voluntary receipts was put in place on October 1, 1993. A new financial management system installed in FY 1993 will account for costs accurately.
- Modernization investments are helping IRS work smarter and faster. A new compliance research system supported by TSM will allow IRS to pinpoint specific problem areas.
- We are consolidating our resources management support in fewer sites and reducing regional and National Office staff. We will put many more of these initiative FTE into the front line compliance related positions.

TRACKING FY 1995 COMPLIANCE INITIATIVES METHODOLOGY

FTE DELIVERY

Through its Automated Financial System, IRS can track FTE delivery by category of employee and organization on a real-time basis. One IRS success measure for delivering the initiative will be realizing all FTE provided to IRS for compliance purposes over the President's baseline budget.

INITIATIVE HIRING

At the Baseline Budget level, IRS would do no hiring in Compliance employment categories -- Revenue Agents, Tax Auditors, Revenue Officers, Special Agents. IRS will track and report on hiring done in these categories nationwide as a result of receiving the Initiative.

RESULTS

To measure revenue results, IRS will use its new Enforcement Revenue Information System which tracks actual revenues from all enforcement cases:

- by amount of tax collected compared to that recommended by auditors;
- by income stratification or audit class;
- by type of tax at issue;
- by time period.

Actual results will be compared to estimates and the reasons for differences specified.

REPORTING FREQUENCY

Revenue results, hiring information and FTE realization will be presented in a comprehensive report on a quarterly basis.

GAO RECOMMENDATIONS REGARDING IRS REVENUE ESTIMATES

GAO RECOMMENDATIONS	IRS ACTIONS
IRS Often Underdelivers Initiatives Because Of Labor Cost Overruns.	IRS Has Worked With OMB During FY 95 Budget Development To More Accurately Project Labor Costs; Include Only Fully Funded FTE In Budgets.
IRS Cannot Track Actual Enforcement Results.	Enforcement Revenue Tracking System Has Been Established.
IRS Should Use More Recent Data To Take Into Account The Effect Appeals Have On Examination Results.	These Changes Have Been Made. IRS Will Be Using Actual Tracking Results From ERIS.
Estimates Do Not Take Into Account Opportunity Costs Of Trainers.	Estimating Procedures Revised To Take Such Costs Into Account.
IRS Should Account For Relatively Lower Productivity For Newly Hired Staff.	Current Methods For Estimating Revenue For Additional Collection Personnel Make Such Adjustments.
IRS Should Track The Results Of New Hires To Gauge Whether Initiative Results Were Achieved.	IRS Disagreed With This Recommendation. In Exam., New Hires Do Not Work Initiative Cases. IRS Policy Is To Avoid Individual Production Statistics.

INTERNAL REVENUE SERVICE
COMPLIANCE PROPOSALS
(\$ in Millions)

	RESOURCES		REVENUE RETURN (\$ Millions)						TOTAL '95-'99
	FTE	FY 1995 \$ MIL	FY 1995	FY 1996	FY 1997	FY 1998	FY 1999		
TAX LAW ENFORCEMENT									
Increase Number of Tax Returns Examined:									
Field Audits (Revenue Agents)	1,582	\$119		\$11	\$176	\$257	\$364	\$764	
Office Audits (Tax Auditors)	633	40	(43)	13	107	264	393	1,141	
Service Center Correspondence Audits	479	27	71	204	284	319	354	1,232	
Collection of Delinquent Taxes	1,222	77	191	542	823	912	912	3,380	
More Effective Use of Information Reporting Documents to Tax Unreported Income	703	54	102	417	672	688	691	2,570	
SUBTOTAL, TAX ENFORCEMENT	4,619	\$317	\$333	\$1,281	\$2,218	\$2,540	\$2,713	\$9,086	
INTERNATIONAL ENFORCEMENT									
International Examinations	90	\$9	(2)	\$3	\$21	\$25	\$46	\$93	
Chief Counsel -- Large Case Initiative	40	5	0	0	0	0	0	0	
SUBTOTAL, INTERNATIONAL	130	\$14	(2)	\$3	\$21	\$25	\$46	\$93	
CRIMINAL ENFORCEMENT									
Fraud Investigations	231	\$56							
Motor Fuel Excise Tax	98	18							
SUBTOTAL, CRIMINAL ENFORCEMENT	329	\$74							
TOTAL COMPLIANCE PROPOSALS									
	5,078	\$405	\$331	\$1,284	\$2,240	\$2,565	\$2,759	\$9,179	

Mr. SPRATT. Mr. Cox, do you have any further questions?

Mr. COX. Thank you. I would just like to follow up on the budget aspect of this. I serve on the Budget Committee. We are taking our budget to the floor in just a few days, and we've just finished markup last week.

In your testimony, and I will just read from it, you say, "Our proposed fiscal year 1995 budget of \$7.613 billion represents an increase of \$261 million or 3.5 percent. Highlights of the budget request include a \$405 million compliance initiative." I read that to mean that the \$7.613 billion includes the \$405 million, in which case, were it not included, you would be looking at a 2 percent cut. But, in fact, isn't it the case that the \$7.613 billion does not include the \$405 million?

Ms. RICHARDSON. That is correct. So if we have left that implication, that was incorrect. The \$405 million is on top of the \$7.6 billion.

Mr. COX. So the 3.5 percent increase does not include the \$405 million and it represents roughly a quarter billion dollar increase over the year before, without the \$405 million; is that right?

Ms. RICHARDSON. That is correct. But \$311 million of that is for Tax Systems Modernization.

Mr. COX. I understand. I understand. But our base in 1994 was \$7.352 billion.

Ms. RICHARDSON. The dollars have gone up; the FTE levels have gone down.

Mr. COX. And we are moving in 1995, without the compliance initiative, to \$7.613 billion or about a quarter billion dollars more?

Ms. RICHARDSON. That is correct.

Mr. COX. And that's a 3.5 percent increase. If we include the compliance initiative, we are looking at a 9 percent increase from last year, taking us over \$8 billion, and we would have to break the caps; right?

Ms. RICHARDSON. No, the \$405 million compliance initiative is outside of the caps completely. It would be part of a budget resolution, and the dollars would go directly to deficit reduction. It's not part of the base budget at all.

Mr. COX. But, in fact, there is no such arrangement right now. Your budget is covered within the discretionary spending caps; isn't that right?

Ms. RICHARDSON. That is correct. Our base budget is within the discretionary spending caps.

Mr. COX. So, in order to have a 9 percent increase in fiscal year 1995 over fiscal year 1994, we would have to break the caps or waive the caps; is that right?

Ms. RICHARDSON. I am not as knowledgeable about the mechanics of the Budget Act as others. But, as I understand it, a precedent was set in 1991, when we did have a revenue initiative which was outside of the caps. I am told that the initiative can be handled through the budget resolution process; it is not a question of having to amend the law or anything.

Mr. COX. Well, specifically, the 1990 budget deal contemplated making room in the caps. It was a flexible cap for the purpose of that initiative. There isn't any such provision in the existing ar-

rangement that defines the caps for a 9-percent increase from fiscal year 1994 to fiscal year 1995. So we would have to waive the caps.

Ms. RICHARDSON. The mechanics, as I say, of how it would be done, I can not address here today. But what we would like to do, and what Secretary Bentsen and Director Panetta have asked is that we be able to work with the Congress, specifically with this subcommittee, and the Budget Committees, to try to work out a way to, within the confines of the budget law, to realize this initiative.

Mr. COX. Just reading from the budget itself, the President and OMB have suggested that they intend to work with the Congress to develop an initiative to consider this spending outside the caps. So I think we are all in agreement that, if the caps remain in place, we can't have the 9-percent increase, and that Congress has to somehow—

Ms. RICHARDSON. We will have to do something with the budget process or the Budget Act, the way the budget is currently structured, to have that \$405 million.

Mr. COX. Now, I want to just explore the rationale for doing that, because the Service's budget right now is considered within the domestic discretionary spending caps. Your argument is that, because the Service is in the business of revenue collection, when you spend more money in the Service, you get more revenue, and shouldn't we, therefore, be willing to make this as an investment? Doesn't that argue for excluding the Service's budget from the spending caps?

Ms. RICHARDSON. We would certainly support that notion, but I am not sure there is general support to do that today.

Long term, I think that that is something that we want to explore with Congress, but, certainly, short term, I think that the fiscal year 1995 approach is a way to begin the process. I think, over the longer term, it would make great good sense to look at all of the revenue-raising agencies of the government in a very different way than we do your other programs.

One of the things that is of most concern to me, I am certainly not a budget expert but I know more about the budget than I did a year ago, is that the process is very much driven by the caps and by certain spending, but never any thought given to the revenue side. We feel, and I think this administration feels, that perhaps you ought to look at the revenue-producing operations of the government somewhat differently than other programs. Perhaps they should be given a different kind of look than just an across-the-board cut every time government spending is cut.

We have, in fact, had to descore over \$6 billion in revenue in the last 4 years because of cuts to the IRS budget. Now, that is money that has had to be made up through tax increases or reduced spending somewhere else. It does not seem to make good business sense. I do not think you would run your business, nor would I, by not taking a hard look at the revenue-producing side of the business and really trying to work with it to make it make sense.

Mr. COX. I want to make sure I understood your earlier response concerning OMB's recommendation that the Service pursue a pilot program of hiring private collection agencies. Did you say that you

would or would not undertake such a pilot performance in fiscal 1995?

Ms. RICHARDSON. What I said, or what I intended to say—

Mr. COX. I'm sorry. Just to make sure I put the question squarely, I'm asking about fiscal 1995. Do you intend to do this during fiscal year 1995?

Ms. RICHARDSON. The reference to the collection out activity was not in the revenue side of the budget. I think that we are having conversations and will be having conversations with OMB about what types of things might be appropriate, but there was nothing included in the budget, based on the revenue side, for a collection out program.

Mr. COX. So, even if we break the spending caps and you get a 9-percent budget increase in fiscal year 1995, your view is, you have no money to do a pilot program for private collection?

Ms. RICHARDSON. I think we would have to take a look at that and also sit down with OMB and see what makes the most sense.

Mr. COX. But you have already done the fiscal year 1995 budget, and you have not included it in the 9-percent increase.

Ms. RICHARDSON. It was never discussed as part of that budget. We never discussed that with OMB as part of the budget.

Mr. COX. I find that, in itself, a reason to oppose the 9-percent increase. I would hope that you would take more seriously Director Panetta's recommendation.

Ms. RICHARDSON. Well, we are certainly going to be talking with them, but it was never discussed prior to the submission of the budget.

Mr. COX. Thank you.

Mr. SPRATT. Let me state for the record an opposing view. I didn't mention the delegation of collection efforts to private agencies, but there are several aspects of Federal taxes which I believe make it inadvisable.

First of all, it's the sanctity of our tax returns, which we have protected for a long time, at least since the onset of the income tax. We have a Privacy Act which basically provides that they are not accessible to anybody outside the Revenue Service without our consent. I think that is a good thing and a conservative principle, and I think it ought to be observed.

Second, as Mr. Dolan said, I think the Internal Revenue Service has some extraordinary devices at its disposal. In order to collect income, you have access to administrative subpoenas, which very few other agencies can utilize. You have a tax lien, a statutory lien, which is just about as broad, encompassing, and tenacious in the way it attaches to real and personal assets as anything known to the law of nonconsensual liens. And I do not think that devices like that should be lightly handed over to private collection agencies, which are known to be heavy handed. That's the way they accomplish their end objectives.

There are some things that are nondelegatable, and I think the collection of Federal income taxes ought to remain in the hands of the government. Just to state an opposing point of view.

[Applause.]

Mr. COX. If I might, just for the record, respond on the merits. I think that OMB's recommendation is for a pilot program, and un-

less we have some real experience with how this might be conducted, we do not know whether our theories are correct or not.

Second, I have daily evidence in my district office, and I suspect that Congressman Spratt and Congressman Horn do, as well, of heavy handedness by the IRS. The Commissioner's sympathies notwithstanding, it isn't always the case, in regional offices and in the field, that people understand when they should stop before they push someone over the cliff into bankruptcy, that the Service might get more money if they worked out a better deal.

Mr. SPRATT. I wholeheartedly agree with you about that.

Mr. COX. There is not conclusive evidence on the record that the way we do it now is the best way and the most sensitive way. I would, for one, like at least to pursue it so that we find out, on the basis of real world data, whether we might, as an augmentation or supplementation, certainly not as a wholesale substitution for what presently we do, whether we can't improve the government's collection efforts. And I think that's why Director Panetta and OMB have made this formal recommendation to IRS.

Ms. RICHARDSON. Mr. Cox, we certainly want to do everything we can to improve the revenue collection efforts. We spend a lot of our energy looking at that very issue. And I hope that you would not leave with the understanding that we are not going to explore every conceivable possibility.

I share Mr. Spratt's concern about the possibility of using private collection agencies. I think we are having further dialog with OMB. I think my comment was that we had had no conversation with them, per se, in connection with the fiscal year 1995 budget about collecting out, but we are certainly cognizant of the fact that we have to look at how we collect revenues and what we can do to enhance the collections. But I do not personally think that contracting out the collection function would be a panacea for increasing collections.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Just in closing, let me say, I happen to agree with my colleague, Chris Cox, that you ought to try that experiment. I think one of the problems with large organizations, and I have run one, not as large as yours, you have a major size in your organization, is the fact that too often experimentation is discouraged by people who say, "Well, we thought about that," or "We tried that 10 years ago or 20 years ago or 30 years ago," or whatever the collective memory is, "and it didn't work."

You are never going to know that until, as Mr. Cox says, you get the empirical evidence one way or the other, if you assume a fair demonstration.

Let me just say, on the ombudsman role of Members of Congress, where both of our colleagues agreed with each other, I think you have some superb people helping members at Laguna Niguel. I have had nothing but cooperation from them.

Let's face it, any large human organization is going to do some dumb things that you will never know about, and none of you sitting at that table will ever know about, as the wheels grind out.

Often it's where nobody has brought the different parts of the agency together before someone slaps a lien which prevents the taxpayer from paying off the obligation, which is over in another

part of the agency not yet resolved as to who owes who. It turned out, in one case that I personally got involved in, the taxpayer was right, and yet—they finally got the lien lifted, understood it, solved the problem, and the taxpayer was right.

I think what you are doing to get empowerment down in the organization is good, I commend you for that. To get the compliance level down there where they can coordinate the different pieces, because going into bankruptcy isn't going to get us any taxes. If the person can pay it, or somebody can make a decision as to what is the fair tax due, then we will all be ahead of it and take the taxpayer in good stead and the government in good stead.

I am going to file for the record a question here that I would like you to answer. Let me read it into the record.

The IRS document on the compliance initiative states that many of the full-time equivalents saved through its modernization effort will be put into the front line, compliance-related positions or enforcement staff. In fact, IRS is asking for 5,000 FTE positions for the compliance initiative.

Three questions: What kind of skills will be necessary for the employees who are working in the front line, compliance-related positions? Second question, what kind of retraining will these FTE's need in order to go from the administrative positions to compliance-related positions? Three, what resources have been allotted to this effort?

If you would just file those answers, I would be appreciative.

Ms. RICHARDSON. We'd be delighted to.

[The information referred to follows:]

- a) There are currently several positions on the front-line for tax compliance. Most of the positions and skills will continue to be required for front-line compliance jobs of the future. These positions and attendant skills are briefly catalogued on the attachments. New positions include: the Customer Service Representative (CSR) which is in development at the Customer Service prototype sites at the Fresno Service Center and Nashville District Office, and the Compliance Officer which is in initial stages of development.

An Occupational Analysis will be conducted by August 31, 1994, on the following positions:

Revenue Officer	Revenue Representative
Revenue Officer Aide	Tax Auditor
Audit Accounting Aide	Customer Service Representative

The Occupational Analysis, including duties, tasks, skills, and proficiency level, will contribute to the Individual Assessment Instrument used by employees to identify their current skill level. This will provide a "gap" analysis between skills needed for a particular occupation and an individual employees actual skills. It will assist in identifying occupational, as well as individual, opportunities/needs for training, retraining and deployment to new positions.

The current front-line positions, necessary skills, and estimated retraining time from an administrative position are detailed below.

REVENUE REPRESENTATIVE GS-592-07

- Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral
 - Interviewing
 - Explaining and persuading
 - Organizing Skills
 - Documentation and recordkeeping
 - Planning steps and methods
 - Time management
 - Workload management
 - Research Skills
 - Finding source documents
 - Researching IDRS
 - Computer Skills
 - Use of TSM tools
 - Application of Tax Procedure
 - Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
 - Decisionmaking
 - Judgement and Working Independently
 - Interpersonal and Negotiating
 - Face to face contact with taxpayer
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Revenue Representative, the retraining time required would be approximately 296 hours.

REVENUE OFFICER AIDE GS-592-06

- Communication Skills
 - Reading comprehension/proofreading
 - Written reports and correspondence writing
 - Oral
 - Interviewing
 - Explaining and persuading
 - Interpersonal relations over telephone
 - Organizing Skills
 - Documentation and recordkeeping
 - Time management
 - Workload management
 - Research Skills
 - Finding source documents
 - Researching IDRS
 - Computer Skills
 - Use of TSM tools
 - Application of Tax Procedure
 - Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
 - Decisionmaking
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Revenue Aide, the retraining time required would be approximately 104 hours.

REVENUE OFFICER GS-1169-09

- Investigative skills
 - Analytical skills
 - Problem identification
 - Problem analysis
 - Problem solving
 - Financial data
 - Recordkeeping
 - Oral and written communication and documentation
 - Decisionmaking
 - Time and workload management
 - Travel management
 - Customer Relations
 - Interpersonal skills
 - Explanation of taxpayer rights
 - Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral
 - Interviewing
 - Explaining and persuading
 - Judgement and Working Independently
 - Interpersonal and Negotiating
 - Face to face contact with taxpayer
 - Basic computer skills
 - Basic budget and accounting skills
 - Research Skills
 - Finding source documents
 - Researching IDRS
 - Application of Tax Procedure
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Revenue Officer, the retraining time required would be approximately 304 hours with on-the-job-training (OJT) time of approximately 1680 hours (42 weeks).

SPECIAL PROCEDURES FUNCTION (SPF) INSOLVENCY TECHNICIAN GS-592-07

- Communication Skills
 - Reading comprehension
 - Transcript reading
 - Written/forms
 - Oral-attorney contact
 - Debtor contact
 - Interpersonal relations
- Organizing Skills
 - Document preparation
 - Recordkeeping
 - Case tracking/monitoring
- Research Skills
 - Researching IDRS
 - Researching other areas
- Case Reviewing and Control Skills
 - Identification
 - Recognition
 - Classification
 - Closing
- Computer Skills
 - Use of TSM tools
 - Use of IDRS
- Application of Tax Procedure
- Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
- Decisionmaking

- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to an SPF Insolvency Technician, the retraining time required would be approximately 40 hours.

COLLECTION ACCOUNT ANALYST GS-592-07 if chosen as Early Intervention Analysts

- Communication Skills
 - Reading comprehension
 - Written communication
 - Oral communication
 - Interviewing via telephone: taxpayers, representatives and third party contacts
 - Interpersonal relations
 - Liaison /consulting
 - Negotiating
 - Organizing Skills
 - Documentation
 - Processing paperwork
 - Computer Skills
 - Use of computerized telephone system
 - Use of TSM tools
 - Research Skills
 - IDRS/ADP/ACS
 - Outside sources
 - Investigative Skills
 - Application of Tax Procedure
 - Analytical Skills
 - Problem identification
 - Problem analysis
 - Problem solving
 - Decisionmaking
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Collection Account Analyst, the retraining time required would be approximately 120 hours with OJT time of approximately 120 hours (3 weeks).

AUDIT ACCOUNTING AIDE GS-503-06**Basic Skills Requirement**

- Communication Skills
 - Reading comprehension/proofreading
 - Written reports and correspondence writing
 - Oral
 - Interviewing
 - Explaining and persuading
 - Interpersonal relations over telephone
 - Organizing Skills
 - Documentation and recordkeeping
 - Time management
 - Workload management
 - Research Skills
 - Finding source documents
 - Researching IRM
 - Researching
 - Computer Skills
 - Use of TSM tools
 - Spreadsheet Construction
 - Wordprocessing
 - Application of Tax Procedure
 - Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
 - Decisionmaking
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

Several of the regions intend to conduct skills assessments in conjunction with redeployments, and then conduct some basic skills training. To transition from an administrative position to an Accounting Aide, the formal retraining time required would be 80 hours of classroom and whatever personal coaching is deemed necessary.

TAX AUDITOR GS-526-05/07**Basic Skills Requirement**

- Investigative skills
 - Analytical skills
 - Problem identification
 - Problem analysis
 - Problem solving
 - Financial data
 - Recordkeeping
 - Oral and written communication and documentation
 - Decisionmaking
 - Time and workload management
 - Travel management
 - Customer Relations
 - Interpersonal skills
 - Explanation of taxpayer rights
 - Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral interviewing
 - Explaining and persuading
 - Judgement and Working Independently
 - Interpersonal and Negotiating
 - Face to face contact with taxpayer
 - Basic computer skills
 - Basic budget and accounting skills
 - Research Skills
 - Finding source documents
 - Researching IRM
 - Researching Tax Services
 - Application of Tax Procedure
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Tax Auditor, the formal retraining time required would be approximately 680 hours (including OJT time; 282 hours of formal training & 398 hours of OJT). As with the Accounting Aide position, some regions are planning to conduct skills assessments and basic skills training for redeployees. In addition to the formal training, we also have an agreement to provide six (6) hours of college accounting in the form of out-service training.

REVENUE AGENT GS-512-05/07**Basic Skills Requirement**

- Twenty-four (24) Hours of college level accounting
 - Investigative skills
 - Analytical skills
 - Problem identification
 - Problem analysis
 - Problem solving
 - Financial data
 - Recordkeeping
 - Oral and written communication and documentation
 - Decisionmaking
 - Time and workload management
 - Travel management
 - Customer Relations
 - Interpersonal skills
 - Explanation of taxpayer rights
 - Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral interviewing
 - Explaining and persuading
 - Judgement and Working Independently
 - Interpersonal and Negotiating
 - Face to face contact with taxpayer
 - Basic computer skills
 - Basic budget and accounting skills
 - Research Skills
 - Finding source documents
 - Researching IRM
 - Researching Tax Services
 - Application of Tax Procedure
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Revenue Agent, the formal retraining time required would be approximately 729 hours (including OJT time; 529 hours of formal training & 200 hours of OJT).

CUSTOMER SERVICE REPRESENTATIVE GS-592-07

- Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral interviewing
 - Explaining and persuading
- Customer Relations
 - Interpersonal skills
 - Explanation of taxpayer rights
- Organizing Skills
 - Documentation and recordkeeping
 - Planning steps and methods
 - Time management
 - Workload management
- Research Skills
 - Finding source documents
 - Researching IDRS
 - Using Probe and Response Guide in conjunction with researching
- Computer Skills
 - Use of TSM tools
- Application of Tax Procedure and Tax Information
- Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
- Decisionmaking
- Judgement and Working Independently

- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Customer Service Representative, the retraining time required would be approximately 296 hours. On-the-Job training is yet to be determined.

COMPLIANCE OFFICER GS-526-09

- Investigative Skills
 - Analytical
 - Problem identification
 - Problem analysis
 - Problem solving
 - Financial data
 - Recordkeeping
 - Decisionmaking
 - Time and Workload Management
 - Customer Relations
 - Interpersonal skills
 - Explanation of taxpayer rights
 - Communication Skills
 - Reading comprehension
 - Written reports and correspondence writing
 - Oral interviewing
 - Interpersonal relations over the telephone
 - Organizing Skills
 - Documentation and recordkeeping
 - Workload management
 - Planning steps and methods
 - Judgement and Working Independently
 - Interpersonal and Negotiating
 - Face to face contact with taxpayer
 - Basic computer skills
 - Generate computerized reports
 - Basic budget and accounting skills
 - Research Skills
 - Researching IRM
 - Researching IDRS and AIMS
 - Researching Tax Services
 - Researching Financial data bases
 - Application of Tax Procedures
- b) What kind of retraining will the FTEs need to go from the administrative positions to compliance-related positions?

From an administrative position to a Compliance Officer, the formal retraining time required would be approximately 680 hours (including OJT time; 282 hours of formal training & 398 hours of OJT).

c) What resources have been allocated to this effort?

The training and retraining efforts are a top priority and vital to the success of the transition implementation. As needs are identified, we reassess the availability of existing funds and redirect resources as appropriate.

Some actions underway to support the retraining effort include:

- Corporate Education has set up teams to put together a new training package for Revenue Agents and Revenue Officer recruits. The modular design includes "pre" and "post" inventories with self-assessment exercises (Diagnostic Testing).
- There are newly restructured phases of training including a fast track course for those who do well on the diagnostic tests.
- The new structure features an earlier introduction to computers and the use of computers as one of the teaching tools.
- District Offices will hold a number of Basic Instructor Training and On-the-Job Instructor Workshops to build their training cadres.

We have begun modeling to roughly estimate retraining costs for the new occupation of Customer Service Representative (CSR) and reinvestment target positions. These calculations are still being refined. The range for training a CSR is \$1,420 to \$2,083 per trainee. This estimate includes the cost of course material/supplies, trainee travel and contractor expenses (space and fees) which is the traditional method of costing training in IRS. To that we have added the travel/per diem of instructors based on an assumption that instructors will have to be in travel status a great deal for this initial wave of training on such a large scale. The computation is also based upon a course length which accounts for various entry skill levels/experience.

Similar computations for reinvestment target jobs:

Revenue Officer Aide, GS-592-06	\$ 2,072 per trainee
Audit Acct Aide, GS-503-06	\$ 2,241
Revenue Officer, GS-1169-09	\$ 6,696
Revenue Representative, GS-592-07	\$ 5,738

The target job costs reflect the actual classroom costs listed in the Training Cost Models.

Mr. SPRATT. Well, we are going to let you go now. If you get any more questions to take home, it's going to be another couple of months before we can get your answers. We would appreciate your responses to the questions that have been submitted for the record. They will help us complete our examination of our subject.

We very much appreciate your testimony, all of your forthright responses, and thank you again for your cooperation.

Ms. RICHARDSON. Thank you very much.

Mr. SPRATT. The next witness is Mr. Robert Tobias.

Mr. Tobias, we also have your testimony, and, if there is no objection, we will make the testimony, as submitted, part of the record, so that you can summarize it in any way you see fit.

STATEMENT OF ROBERT TOBIAS, NATIONAL PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Mr. TOBIAS. Thank you very much, Mr. Chairman. I really appreciate this opportunity to testify with respect to Internal Revenue Service budget.

I start with the proposition that the Internal Revenue Service is primarily responsible for nurturing and preserving the voluntary tax compliance system in the United States. The IRS is responsible for generating 90 percent of the \$1.6 trillion budget submitted in 1995. To be successful, the IRS needs a combination of increased compliance activities and educational effort to increase the voluntary compliance level.

Currently, voluntary compliance is at 83 percent, with an IRS stated goal of 90 percent. As the Commissioner testified, every 1-percent increase leads to an increase in revenue between \$7 billion and \$10 billion. We must increase voluntary compliance for essentially two reasons: One, it increases revenues; but more importantly and also critically essential is that it increases confidence and credibility in the system.

If the voluntary compliance system is falling, it falls at a geometric rate, because more and more people feel that they do not have to pay the proper amount. So the voluntary compliance level is critically important to the success of the system.

We can only increase voluntary compliance through a combination of increased efficiency, increased education, and increased compliance activities. The fiscal year 1995 budget standing alone is inadequate to accomplish the task. It would reduce the work force by 3,169 employees in key functions: examination, collection, taxpayer services, and document matching.

The results of this decrease are predictable. The number of audited returns drops from 1.5 to 1.3 million and 1.5 to 1.03 percent. Recommended taxes and penalties fall from \$23 billion in 1993 to \$21.7 billion in 1994 and \$21.5 billion in 1995. The accounts receivable inventory, the number of cases unprocessed, will increase from 4.1 to 4.6 million.

During the same period, the number of delinquent returns investigated of nonfilers will fall by 300,000, while the backlog of inventory will increase by about 100,000. And revenue collected from delinquent accounts will decrease by about \$66 million. The TDA dollar inventory projected will increase from \$27.2 billion in 1993 to \$27.9 billion in 1994 to \$31.9 billion in 1995. The number of docu-

ments matched decreases. The number of unanswered calls increases.

So I think it is pretty clear that if we measure our effort in terms of voluntary compliance, the budget, as submitted, doesn't get the job done. The TSM effort which Congress has been funding will give the IRS tremendous new efficiency and new opportunities, but they will not be realized without additional compliance activities. They will not be realized without the proposed 5,000 FTE revenue initiative that has been proposed.

The cost of the effort is \$405 million per year or a little over \$2 billion over 5 years. It is projected that the return will very conservatively yield \$9.8 billion over the same period. The compliance initiative would focus on an increase in the number of tax returns examined and increase the collection of delinquent taxes.

The projected revenue is not projected fiction; rather, it is based on the calculation from the 1991 initiatives which are already ahead of schedule. The 5-year goal for the 1991 initiatives was \$9.7 billion but by September 1993 had already collected \$13.6 billion, or \$4 billion over. What was projected in 5 years, we got in 3 years.

We are in a position to talk about revenue initiatives and more compliance activities because of the TSM effort. More hardware and more software would allow the IRS to use significantly fewer employees to do the tax processing work. When we are talking about the tax processing work, we are talking about the real grunt work of the Internal Revenue Service, the stuff that is done by hand in the service centers. If you have been in one of those service centers, it looks much like an assembly line operation.

By removing that kind of work and redeploying those folks to compliance activity, by providing taxpayer assistance, following up on taxpayer correspondence, collecting delinquent accounts, and conducting audits, we can make a dent in that voluntary compliance rate; we can make a dent in the accounts receivable inventory.

Now, the redeployment agreement that was signed by NTEU and IRS envisions a redeployment of those employees who are no longer needed to do tax processing to compliance activities. The redeployment will require skills assessments and training on an extremely large scale. I think the job can be accomplished because we are starting early.

We are looking at each job on a job-by-job basis to figure out how those jobs can be phased out and the new jobs be phased in over a 7-year implementation period. We are prototyping skills assessment, to be followed by training specifically tailored to the needs of the affected employee. Training and development are critical to the ultimate success of the IRS, TSM, and redeployment effort. The training can't come in spurts; it must be available as jobs are phased out and new opportunities created.

I am extremely hopeful, Mr. Chairman, that you and your committee will recommend to the Budget Committee that the \$2 billion initiative be funded outside the discretionary caps in the budget resolution conference report.

Thank you very much for the opportunity to testify.

[The prepared statement of Mr. Tobias follows:]



STATEMENT OF
ROBERT M. TOBIAS
NATIONAL PRESIDENT
NATIONAL TREASURY EMPLOYEES UNION

TO THE

SUBCOMMITTEE ON
COMMERCE, CONSUMER, AND MONETARY AFFAIRS
COMMITTEE ON GOVERNMENT OPERATIONS
HON. JOHN N. SPRATT, JR., CHAIRMAN

INTERNAL REVENUE SERVICE BUDGET FOR FY 1995

HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

MARCH 8, 1994

Mr. Chairman and Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union. NTEU is the exclusive representative of over 150,000 Federal employees, including virtually all employees of the Internal Revenue Service. On behalf of the men and women who collect the revenue of the Federal government, I am pleased to be here today to present our Union's views on the Internal Revenue Service budget request for FY 1995.

IRS employees are mindful of the heavy responsibility they bear for administration of the nation's tax system. Our voluntary compliance system depends crucially on taxpayers' perception that IRS workers are doing a good job steering the tax system with fairness and efficiency. The budgetary challenge is how to accomplish this with a growing taxpayer population and limited resources.

You have asked us to address three things. First, the budget request for IRS proposed by the President. Second, the President's pending legislative proposal for a 5,000 FTE revenue initiative to be earmarked for deficit reduction. Third, whether management of technical change through worker redeployment and retraining will be adequate to the task.

The Administration's FY 1995 Budget Request for IRS

We believe the Administration's FY 1995 budget request for IRS

would have serious adverse consequences for the nation's tax system and should not be adopted unless combined with the 5,000 FTE revenue initiative proposed by the President. NTEU does not support the budget as a stand-alone measure. It must be a baseline for FTE resources to be added -- resources that would conservatively generate \$9.8 billion over 5 years.

Without the initiative, the budget is sadly inadequate to the needs of a growing taxpayer population and the largely uncontrollable demand from taxpayers for assistance. The budget accepts a sharp deterioration in IRS' ability to follow up on a minimally adequate level of compliance inventories -- examinations, accounts receivable, delinquent returns, underreporter notices, and the like. It is an every day fact of life at IRS that while the computer has greatly increased the Service's ability to identify potentially non-compliant taxpayers, the percentage of cases actually worked continues to fall as the population of returns rises.

The results are portrayed in the budget statement itself. Overall, IRS would fall from 112,825 FTE in FY 1994 to 109,656 FTE in FY 1995, a reduction of 3,169. The reductions in selected major functions are as follows:

	<u>FY 1994</u>	<u>FY 1995</u>	<u>Reduction</u>
Taxpayer Services	8,306	8,057	-249
Returns Processing	22,211	21,563	-648
Examination	27,037	26,044	-993
International	668	655	-13
Collection	17,463	17,125	-338
Document Matching	3,674	3,469	-205

FY 1995 resource levels are even more stark when compared to FY 1993 levels:

	<u>FY 1993</u>	<u>FY 1995</u>	<u>Reduction</u>
Taxpayer Services	8,688	8,057	-631
Returns Processing	25,585	21,563	-4,022
Examination	29,665	26,044	-3,621
International	864	655	-209
Collection	19,257	17,125	-2,132
Document Matching	4,165	3,469	-696

Here you have a classic example of a go-and-stop budget policy -- a practice that knowledgeable observers of tax administration have routinely deplored. In FY 1993 the system was humming, then the brakes were slammed on in 1994 and even harder in 1995.

The results are predictable:

[b] The number of returns examined drops by more than 200,000 between FY 94 and FY 95, from 1.5 to 1.3 million returns. This plunges audit coverage from 1.25% to 1.03%.

[b] Recommended taxes and penalties from exams falls from \$23 billion in FY 1993 to \$21.7 billion in FY 1994 and \$21.5 billion in FY 1995 -- a potential loss of revenue that cumulates each year that the system has been stopped in its tracks. Not all recommended taxes and penalties are ultimately collected, but there is not only a substantial direct revenue loss, there is also a substantial indirect revenue loss from declining compliance associated with declining audit coverage. The \$120 billion tax gap will grow faster, while IRS enforcement measures will take a smaller

chunk out of the gap each year.

- [b] The number of Appeals Officers will fall from 1,180 in FY 1993 to 1,143 in FY 1995 -- a pennywise and poundfoolish reduction, because Appeals Officers save taxpayers millions of dollars and the Service can ill-afford to make any reduction in this highly trained corps while workload levels remain as high in 1995 as in 1993.
- [b] The number of examinations, delinquent account dispositions, delinquent returns secured, and taxpayers assisted by the International Division will remain flat between FY 1993 and FY 1995, despite steady growth in inventories to be processed.
- [b] In collection, the accounts receivable backlog in active inventory (the largest and most serious accounts) is projected to rise from 4.1 million to 4.6 million from FY 1993 to FY 1995 -- an increase in the backlog by a half million accounts in two years. During the same period, the number of delinquent returns investigations of non-filers will fall by 300,000, while the backlog of cases in active inventory rises by nearly 100,000. Revenue collected from taxpayer delinquent accounts actually falls (despite inflation) by \$66 million. At the same time, the amount of revenue in the active inventory backlog, which is the best measure of revenue legally owed but not being collected by the government in large and serious cases, is projected to rise from \$27.2 billion in FY 93 to \$27.9 billion in FY 94, and to \$31.9 billion in FY 1995. This represents a potential loss of \$4

billion each year from now on.

[b] In Document Matching (Information Returns Program), the number of underreporter contacts falls from 2.7 to 2.5 million between 1993 to 1995. The number of substitute for return closures falls by nearly 200,000, and the number of non-filer notices by 67,000. Net underreporter assessments drop from \$1.5 billion to \$1.2 billion, and substitute for return assessments fall from \$2.1 billion to \$1.8 billion. This is a total loss of \$600 million annually in assessments, but the indirect impact on voluntary compliance will no doubt be even more severe.

[b] In Taxpayer Service, the number of taxpayers projected to be served by the backbone of the system -- the toll-free telephone -- is scheduled to rise from 35.9 to 37.5 million between FY 93 and FY 95 despite a 631 FTE cut. It is important to recognize that the number of taxpayers seeking assistance is rising each year, so that overall service level or percentage of taxpayers assisted is falling. This means more and more busy signals and more and more calls terminated without contacting an assistor -- a very unhealthy impact on voluntary compliance. A few years ago, IRS set a service level objective of 85%, but now it does not even publish the figure in its budget. We estimate that probably 4 out of 10 taxpayers who call IRS will not get through if this budget is adopted.

While these impacts on revenues and operations depict the

consequences of the Administration's budget, these are by no means the larger and more serious consequences. A stop-and-go budget projects its consequences long into the future. The impact on taxpayer attitudes, their perception of the fairness of the tax system when IRS cannot bring non-compliant taxpayers to account, can wreak incalculable damage. Whatever damages voluntary compliance entails not only an enormous loss of revenue (\$7 billion for each one percent decline in the compliance rate), but has the potential of disillusioning taxpayers with the system in ways that may prove difficult to reverse.

The irony is that, with better technology, IRS has better means to identify non-compliance; what it lacks are the means to pursue and deter it. Thus, the Federal government is failing to realize full value from its investment in Tax System Modernization. The IRS should be congratulated for setting a goal of reaching 90% compliance by the year 2001, but the FY 1995 base budget proposal will not accommodate that goal without the addition of the 5,000 FTE revenue initiative.

The Administration's Proposed 5,000 FTE Revenue Initiative

The President's budget contains a brief description of the proposed 5,000 FTE revenue initiative. It states as follows:

"IRS Initiative -- The 1990 budget agreement included an IRS tax compliance initiative, which provided additional funding for activities that would reasonably be expected

to increase revenue collections. The Administration is considering a similar multi-year IRS initiative-- beginning in 1995--to increase taxpayer compliance further. This initiative would add 5,000 FTEs to compliance efforts in 1995, most of whom would be used to increase the number of focused examinations of tax returns to collect more delinquent taxes, and to make more effective use of information-reporting documents.

"The cost of this program would be \$405 million per year, or \$2.025 billion over 5 years. The initiative will yield far more revenue than it costs over the five-year period, and would continue to enhance tax revenue after that period (assuming continued funding at the same rate.) In view of this deficit-reducing potential, the Administration would consider budgetary treatment similar to the 1990 budget agreement, under which the cost of the initiative was considered outside the discretionary caps. Under no circumstances would the Administration permit projected additional revenues to fund mandatory spending increases or tax reductions. Subsequent to the release of the President's budget, the Administration will work with the Congress to develop such an

initiative. Therefore, the revenue yield and costs of this initiative are not reflected in the President's 1995 budget itself."

IRS has provided the following estimate made by Treasury's Office of Tax Analysis of the total revenue of \$9.8 billion projected for the initiative:

Revenue in Billions

<u>FY 95</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>TOTAL</u>
.5	1.4	2.3	2.7	2.9	9.8

The bulk of the 5,000 positions (4,619) would come in the area of tax enforcement. The focus of these positions would be on increasing the number of tax returns examined and increasing the collection of delinquent taxes.

NTEU strongly supports enactment of the initiative as requested by the President. Since the additional revenues will be used for deficit reduction, it is especially important that the final budget resolution count the cost of the initiative outside the budgetary caps for discretionary expenditures. We urge this Subcommittee to not only support the initiative, but to submit to the Budget Committee a strong recommendation that the \$2 billion cost of the initiative be funded outside the discretionary caps in the budget resolution conference report.

Overall, the initiative is expected to produce nearly \$10 billion at a cost of \$2 billion, or a yield-to-cost return of \$5

for every dollar invested in improved compliance. There is reason to believe that Treasury's revenue estimate is probably conservative. We base this on the results to date of the FY 1991-1995 initiative, which by September 1993 had already exceeded its objective.

According to IRS' Tracking Report for the FY 1991 Compliance Initiative, the five-year goal was \$9.778 billion, but through September 1993 IRS had collected \$13.6 billion, thereby exceeding the goal by nearly \$4 billion. Most of this exceptional performance stemmed from Counsel/Appeals closing more higher-yielding cases, accelerated closure of coordinated examination program (CEP) audits, and higher than expected yield from excise tax examinations. It is unlikely that the President's proposal will rely on the same program mix as the 1991 initiative, but experience since 1991 indicates that a well-conceived compliance initiative would be a good bet.

NTEU supports the President's proposal not only because it will reduce the deficit, and repair the gaps in the IRS budget, but because it aims at improving the overall level of compliance. There is strong evidence from IRS' tax gap, non-filer, and accounts receivable studies that voluntary compliance needs shoring up. The indirect effect of stronger enforcement on compliance has the potential of delivering a large additional revenue yield. Most importantly, we will be strengthening and preserving one of our most important institutions, the voluntary compliance system.

Redeployment and Retraining Within IRS

Technological advance creates higher-skilled and higher paying jobs while giving IRS employees modern tools to carry out their missions. It is a fact of life that organizations must continually reinvent the way they perform their work in order to absorb the latest technology. IRS and NTEU now confront this task on a scale never before experienced. Implementation of IRS' strategic Business Vision will send organizational change cascading through the workforce, requiring redeployment to compliance activities of large numbers of workers no longer needed in customer service and processing operations.

IRS and NTEU have agreed to work together to manage change to create a highly-skilled work force with expanded capabilities to serve the taxpaying public. Central to this task is a commitment to retraining and redeployment of those who see their jobs and career opportunities threatened by technological advance. The Subcommittee has asked whether this is a feasible concept, in that many clerical workers may not be able to absorb the training essential to perform compliance functions. Allow me to address this issue.

Workforce management requires a broad range of tools to enable an organization to acquire the mix of skills needed to do its job. Retraining and redeployment are critically important, but so is the ability to recruit from the outside by being competitive in the marketplace for technical talent and educated entry-level workers. So is the ability to offer career progression in a chosen specialty, and provide incentives to skilled workers to remain with

the Service for a full and satisfying career. There are other management tools -- term appointments, directed reassignments, use of part-time and temporary workers, and many others -- in the kit of human resource managers. All of these tools must be used together to attain the goal of a highly-skilled workforce and the right mix of occupations.

Some individuals may not be retrainable for some occupations, and this can be identified early on through performance reviews and aptitude testing. Under the Redeployment Understanding concluded by IRS and NTEU last year, other opportunities will be sought for such workers, if they are career and career conditional employees, to enable them to maintain their grades. These opportunities include further training and extended on-the-job training assistance.

The fact that some individuals may not be retrainable does not invalidate the soundness of the joint commitment by NTEU and IRS to use retraining and redeployment extensively to manage change. What we are saying is that we expect more compliance jobs to open up as the savings from TSM are redirected to the line. We will look carefully at the skill requirements of those jobs and match them with the pool of redeployable workers, using training where appropriate to ensure that the match is complete.

Under the joint Redeployment Understanding, this process of matching workers to available jobs is worked out locally, job by job and worker by worker. A successful personnel program makes its mark one individual at a time. You can rest assured that there

will not be a wholesale dumping of clerical workers into enforcement jobs. Our Understanding provides for competitive hiring from the outside if available jobs cannot be properly filled from the pool of redeployment eligibles. But IRS and NTEU have agreed that, before going outside the Service, we will make every effort to retrain and redeploy our career and career conditional workers.

The objective is to place permanent employees into permanent positions, and seasonal employees into seasonal positions. The Understanding contains a set of principles to guide local units in implementing this. It provides for preparation of local plans at each site with redeployment eligibles, and for recall of career and career conditional seasonal employees to allow them to remain in work status for a sufficient period to ensure maintaining the full range of employee benefits, including health insurance.

NTEU and IRS have agreed to develop specific site redeployment plans no later than July 1, 1994. These redeployment plans will identify how the parties will accomplish redeployment of eligible employees by January 1, 1999. The plans will maximize the use of saved grade and pay authorities, job sharing opportunities, and the part-time career act. It will utilize incentives, such as early-out retirements and resignation buyouts, authorized by the Federal Workforce Restructuring Act currently pending before Congress. IRS has agreed to an important provision which will divide early-outs and resignation buyouts equally between redeployment eligibles and other employees on a service-wide basis. Redeployment plans will provide a reasonable amount of official

time to enable eligible workers to participate in career planning and counseling, including individual career assessment and aggressive outplacement assistance.

To interpret the Understanding, approve local site plans, and render binding decisions in case of disagreement, IRS and NTEU have established a Redeployment Resolution Council. NTEU and IRS each have two positions on the Council, and there will be a neutral third party chosen by NTEU and IRS representatives.

I have previously mentioned the importance of education and training to the redeployment program because it gives us the ability to match the right skills to the right job. The Understanding states:

"The IRS recognizes that employee training and retraining is a critical component of a successful redeployment effort and budget decisions must be made which reflect this priority." . . .

"IRS and NTEU recognize there are many redeployment eligible employees who are not basically qualified for some continuing positions. IRS and NTEU will explore providing skill enhancement training:

1. Internally through the IRS Corporate Education Program
2. Externally from colleges and universities."

In closing, Mr. Chairman, you can see that both IRS and NTEU attach great importance to education and training, not only to meet current redeployment needs, but as an indispensable resource to enable the Service to continue to "reinvent itself" as technology develops. The training base in IRS needs urgent budgetary attention. Congress must ensure that education and training funds are not cut. We need an "education and training chairman" who will

give priority attention to this area. We hope we can count on you.

Mr. Chairman, this concludes my statement. Are there any questions?

Mr. SPRATT. Thank you very much, Mr. Tobias.

You raise a question that we didn't cover with the Commissioner, and that is if we have the compliance initiative, whether we can take the people who are going to be freed up from different positions, examiners, processors, people who are right now working the assembly line, as you put it, and make them customer service reps who can, respond online, to questions that taxpayers have when they call in to the Internal Revenue Service, or become examiners and sit examine, astutely, returns that are filed.

Is this possible? Are we confusing in our minds the types of skills that are out there and simply assuming that you can take an apple here and make it an orange there?

Mr. TOBIAS. I think not, Mr. Chairman. I think that what we are finding now, and what we are going to be finding in the future, is that the skills of these people in the service centers are vastly underutilized, that we have acquired in the service center a work force that is vastly overqualified for the kind of work that they are currently performing, and in fact are eager and able to be trained to do new and more difficult work, and, of course, new and more difficult work that will pay them a little bit more money than the work that they are performing today.

Mr. SPRATT. How much training is going to be required to take somebody who is essentially doing a data input job today and giving that person much more cognitive responsibilities, let's say?

Mr. TOBIAS. Well, for example, I think Mr. Mader testified earlier that, over the last 2 or 3 years, 4,000 people who were doing that kind of work are now tax examiners, which is the sort of entry level work that is performed in centers, the entry level examination, taxpayer correspondence, and response to taxpayer kind of work. And these people are doing a good job.

So I think that it is possible to make that transformation. I certainly am not going to tell you, Mr. Chairman, that every single person who is doing this kind of work can do more complex, more difficult work. That's just not true. But I think that the vast majority can.

And I think for those who can't there will remain some of this lower skilled work. It is still going to be done in the centers, because every single return is not going to be filed electronically, every single return is not going to be scanned in. So there is still going to be some work left over after all of the hardware and software is implemented in the 7-year period.

Mr. SPRATT. What is your impression, overall, of TSM, Tax Systems Modernization?

Mr. TOBIAS. It's kind of interesting. I was speaking to a consultant not so long ago, who was working with the Internal Revenue Service, and I asked him why he was doing the work, because he was complaining vigorously about the competition that was inherent in getting the job. He was used to buddying up to some CEO and getting the consultant work.

And he said that he sought the work aggressively because TSM constituted the largest change effort going on in the country today, in the public or private sector. So the implementation of the hardware and software, coupled with the leveraging of the increased ef-

iciency and productivity, is, he described, the largest change effort going on anywhere.

Mr. SPRATT. Do you agree with that assessment? Is it that revolutionary?

Mr. TOBIAS. I believe that, in the next 7 years, every single Internal Revenue Service employee will be touched by Tax Systems Modernization. I mean, when the Commissioner was talking about a taxpayer calling the Internal Revenue Service and, similar to American Express, being able to receive a correction in a tax return in one call, that will transform the way we do business. And the goal is that 95 percent of the time that will happen.

Right now, the data is in three or four different data bases. We have to ask somebody to bring us the return, and we look at the return, and then we write back. Then, as she said, the stuff crosses in the mail. It's very inefficient and very ineffective.

It will, in fact, make a huge difference. If you're a revenue agent, you will be able to have access to data bases, independent data bases, that you just do not have access to today, to determine the kinds of returns that you will audit, and once you audit them, to compare this return against a larger data base. It will change very dramatically, in a positive way, the way the Internal Revenue Service does business.

Mr. SPRATT. Do you think it's working to the extent that the personnel outlined in your testimony, on pages 2 and 3, are truly, really being freed up so that they can be redeployed? For example, taxpayer services, 631 positions. Returns processing, 4,022 positions. Examinations, 3,621 positions. Is TSM working to the point where it is freeing up these resources so that they can be channeled into more focused compliance efforts?

Mr. TOBIAS. I think I was putting the information on pages 2 and 3, Mr. Chairman, to point out that the budget, as proposed, is inadequate, and that if this is the way it's implemented, we will be in a failure mode. That's why I'm urging that what's on 2 and 3 be supplemented by the compliance initiative and that we not have a net reduction of 3,621 people in examination, but that we have perhaps a reduction of somewhere in the neighborhood of 1,500 rather than 3,600, when you add the people that will be brought back through the compliance initiative.

Pages 2 and 3 are to show what would happen in the worst case scenario, and I think it would be a significant problem. The only place we see the impact of TSM to date is in returns processing. That's the only real place we are seeing just the initial, incremental leveraging of TSM. The real large impact is going to come in fiscal years 1996 and 1997, with the huge purchases of hardware that are on the way.

Mr. SPRATT. I have some more questions. Let me turn it over to Mr. Cox and then Mr. Horn, then I will come back with a few more questions.

Mr. Cox.

Mr. COX. Yes. It seems to me that the redeployment understanding is probably at the core of how IRS is going to implement the TSM changes throughout the work force. You have described it somewhat in your testimony. I also understand that our staff, at one point, had a copy of it. I wonder if I might just ask if you could

provide us with one, because right now we do not have a copy of it.

Mr. TOBIAS. I would be glad to do that.

Mr. COX. I appreciate that.

Most of what you describe about the redeployment understanding is comforting. You state in your testimony that there will not be a wholesale dumping of clerical workers into enforcement jobs and that what you are really after is trying to make sure that you look inside first. And if you can't find the right people for the job inside, then you go outside.

All of my experience in the workplace suggests to me that management usually overlooks people inside, because it always looks more attractive to hire somebody outside. You only see their résumés. You only see the good things they have done in life. You have to hire them to find out what they can't do.

Mr. TOBIAS. Where their warts are.

Mr. COX. Exactly. Exactly. So I think that that is all to the good and that the nut crunching comes when we make the fine distinction: We are looking inside first. We are interested in maintaining as many existing personnel as possible. Is this person trainable or not? How much should we invest in finding out? Is it cheaper to go outside, and so on?

I have to say that I have my doubts about how far we can take this notion of training people, as it were, from scratch. To the extent we are talking about someone who was a clerical worker at the outset, the amount of training required to get from here to there is absolutely extraordinary.

Mr. TOBIAS. Well, Mr. Cox, I really think that you may be overestimating the amount of training that is needed, and particularly, I guess, with respect to the conversation that you were having with the Commissioner about contracting out.

In all of the discussions that have occurred about contracting out in the past, the real issue has not been to assign tax delinquent accounts to somebody on the outside and have them go out into the field and seize goods or unpaid taxes. The issue has been whether or not there might be some way of using outside people to make telephone calls at an earlier stage in the collection process. Because we certainly know that, if we call a taxpayer 2 months after they fail to pay, you are much more likely to get money than if you wait for 2 years.

Now, the kind of people who work in these centers are particularly and peculiarly able, with not a great deal of training, to do that kind of work. And they already are in the Internal Revenue Service, they are already in the system, so applying those people to that kind of work would indeed be a savings in comparison to any kind of contemplated contracting out.

So there is a perfect example of how people with not a whole lot of training, not the same amount of training that would have to be applied to someone from the outside, if you were to give them that work, could do that kind of work and have a real huge bang for the buck.

Mr. COX. Well, there are really two issues here. The pilot program that OMB has suggested would, in the near term, in any case, be just that. So it wouldn't really make a mark on IRS's over-

all business, and certainly it wouldn't substitute in any way for career or career conditional employees at the service.

In addition, we are talking about not only audit work or collection work but also the kind of tax advice over the telephone that the chairman referred to.

Mr. TOBIAS. That's correct.

Mr. COX. It takes very little to get somebody's tax return into a complicated question. Once you go a little bit beyond the W-2, if you have a condo that you are trying to sell and you can't sell it over an extended period of time, so you take a renter in, suddenly you're a landlord. If you have any kind of savings at all, and you make the mistake of putting it into some securities of any kind, suddenly you have all kinds of issues about original issue discount, capital gains, and so on.

Mr. TOBIAS. And one of the ways that we—

Mr. COX. If you are self-employed, you have all manner of questions about cost of goods and legitimate business deductions.

Mr. TOBIAS. But the way we handle that—we have a method of handling that, and we do not have one person who has an encyclopedic knowledge of the tax code. We can't train anyone to have that kind of knowledge, so we have specialists. This is actually one of the reasons that has led to such dramatic increase in the accuracy rate of the telephone calls.

I think Mr. Westfall testified that, when someone calls in to many of the sites, they can self-select, if they have a specialized question, to a person who is a specialist in that area. If one of the taxpayer assistants gets a call, the answer to which they do not know, they immediately send it to a specialist to provide the answer, as opposed to either giving an incorrect answer or no answer.

So we really have met the issue of complex questions by providing specialists as backup to answer the questions.

Mr. COX. I think that is absolutely essential. There is no question that the degree of difficulty involved in answering many tax questions that are common to the returns of ordinary Joes and Janes goes far beyond what you might learn in a few months.

I should say that I used to teach Federal income tax at Harvard, and I had the occasion one time to be on television with Fred Goldberg, who was then Commissioner. Fred and I actually used to practice law together. And I asked him on the air whether or not he used an accountant to help him prepare his tax return. He is one of America's finest tax lawyers, in addition to having been Commissioner at the moment.

And I told him that, even though I used to teach the subject, I found it necessary, even though I was now just a government employee and had a pretty simple return, to use an accountant. He acknowledged that he did too.

I do not think we do a service to the citizenry, generally, if we try to trivialize the complexity of the Code, the regs, and compliance with it. I will just share with you two cases that I have ongoing, that I have been working with some time.

One of my constituents, I will call her Emily, was notified in 1990 that she owed \$22,700. To meet the liability, she sold her house and paid the IRS, on the spot, \$20,000 in equity from the sale. As a result of that transaction and after that transaction, she

had no income and moved into—I've seen it—a rundown apartment. She struggled to work out a payment plan. The IRS stalled and delayed, and she now owes over \$30,000 from the same liability as a result of penalties and interest.

She first filed an offer in compromise, in October 1991, and heard nothing, although she followed up many times. She finally received a call, in January 1993, and was asked to update her offer because it was no longer current. She met with a representative from the IRS in March, who stated that she would recommend acceptance of Emily's offer.

Last October she received another call from the same Service official who stated she would again need a new offer because the offer they had was outdated. This gentleman stated that he had not had time to review her earlier offer. Emily was told that, if her new offer was not submitted the next day, it would automatically be rejected. She complied, but at this point, 3½ years after starting out, Emily is still trying to pay her liability. She has been given no response from the IRS to the date of this hearing, nearly a half year after her last proposal.

The bottom line is that, because of the way the Service handled this, Emily will likely be filing for bankruptcy. Under the chapter she will be filing, the Service's debt will be discharged, and the IRS will get nothing instead of the amount she was offering, which she was going to borrow, because she hasn't any assets or savings. In this case, neither the government nor Emily benefited from the IRS intransigence.

The second case involves a small business. The company executive had a liability with the IRS that he tried for several years to address and to pay. The IRS transferred the file no less than three times and lost it no less than four times. His file was lost at the IRS for 6 months on a single occasion.

The truly horrifying bottom line of this case is that interest and penalties accrued while the business was trying to pay its liability. I contacted the local IRS office several times, legislative affairs here in Washington, DC, and the Office of Tax Policy. The case still hasn't been resolved. The business has reduced its work force, and it hasn't, of course, been able to invest in new products which are critical to its economic future.

The IRS is going to generate, as these two cases illustrate, far more revenue if we have business-savvy people, sensitive to negotiation as well as the vagaries of the tax law, in these positions. Maybe such people need to be paid more.

Mr. TOBIAS. You'd get a lot of agreement with that.

Mr. COX. I think that's right. I do not deny the degree of difficulty involved. I've met with NTEU employees many times and heard the stories. I know what it's like being on the other side from hearing these stories. I know there is even threat to life and limb, on many occasions. So, in addition to being a tax expert, you might need to be a self-defense expert.

Mr. TOBIAS. Well, the fact is that the revenue officers in the Internal Revenue Service are subject to more assaults than any other group of employees in the Federal Government, including FBI, including DEA, including CIA.

Mr. COX. The irony is that this can be a vicious circle unless, in virtually every case, we are providing the best kind of expertise to solve the problem. Otherwise, we end up using a lot of man and woman hours, but we do not get the result. We can take up 3½ years with a case like this and end up with no money. And all the time that has gone into it, ultimately, you would have to chalk up to a deadweight loss.

It is a compassionate objective to try to preserve everybody's job, but I would just suggest that the kind of compassion that we really need, as a government, is compassion toward the millions of citizens who pay taxes. They are the ones most in need of compassion and service. And the process, if directed that way, is going to yield more revenues to the government at the same time.

Mr. TOBIAS. Well, I can assure you, Mr. Cox, that your concerns are well protected by the Internal Revenue Service management group who, as a group, have historically had more discharges and disciplinary actions against Internal Revenue Service employees than any other agency. So I think that they are particularly aggressive in ensuring that the standards that are articulated for Internal Revenue Service employees are followed.

This redeployment effort is not a make-work effort, and it's not a job preservation effort. It's a reinvestment effort of people who have skills and abilities and are able, I believe, through training, to make significant contributions to the public. I mean, that's what this is all about. I believe that we can deliver on that over and over and over again.

So I believe that the interests that you have just articulated are going to be well protected.

Mr. COX. Thank you.

Mr. SPRATT. Mr. Horn.

Mr. HORN. Thank you, Mr. Chairman.

Mr. Tobias, you probably heard the question I asked for the record. Let me ask it to you on the record. In essence, the IRS says that many full-time equivalents, FTE's, will be made available through TSM, and they will be put in front line, compliance-related positions or enforcement staff.

So, question one, what kind of skills will be necessary for the employees who are working in front line, compliance-related positions? What is your assessment of that?

Mr. TOBIAS. Well, it depends on the job to which these people are assigned. Tax examiner is the least skilled job. The backbone of the new IRS is the customer service representative. That job has not been specifically designed. We are in the process of doing that right now. The customer service jobs will include what has heretofore been done at the automated collection sites and taxpayer service. And then the more traditional jobs of tax auditor, revenue agent, revenue officer.

I also see that some of these people can perform jobs as audit aides and collection aides, assisting revenue agents and revenue officers with the lesser skilled kind of work, thereby freeing them up to do the more complex work, similar, not exactly the same, but similar to a paralegal kind of operation.

Mr. HORN. What sort of supervision modules are we talking about? One supervisor that sees the total picture could maybe run seven of these paraprofessionals?

Mr. TOBIAS. I really do not know the answer to that. I do not know what the structure will look like, because, as I say, we are just in the process now of trying to design the work flow, design the work and the work flow.

Mr. HORN. Well, looking at the people who might be displaced as a result of modernization, automation, all those things, and sort of having some sort of feel for the types of skills they now possess, what are we talking about in terms of likely jobs that will still be available and might grow? Are we talking about, one, traits of personality, such as being pleasant to people and articulate and can be understood at the other end of the telephone? Is that one category?

Mr. TOBIAS. Sure. Sure.

Mr. HORN. OK. How much formal education, if any, is needed to perform the type of skills in jobs that might be available, high school degree, community college degree, bachelor's degree from a college or university?

Mr. TOBIAS. Currently, in the taxpayer service operations, a high school degree is required.

Mr. HORN. Is that a sufficient literacy level in your judgment?

Mr. TOBIAS. With training it is, yes.

Mr. HORN. Any other skills? Personality, some literacy, ability to read instructions, whatnot?

Mr. TOBIAS. Sure.

Mr. HORN. What else do we need?

Mr. TOBIAS. I think the mix of those skills will depend on the job. I mean, if someone is a revenue agent, obviously, the analytical skills would predominate over the personality skills. If someone is a customer service representative, the personality skills might predominate over the analytical skills. So I think it's really the mix of skills will depend on the specific job. I mean, if someone is an audit aide, then someone has to be very quick with numbers.

Mr. HORN. As you look at the current training given by IRS when they bring people into the system for these jobs, are there any additions that are needed, when we are talking about people that are already there doing other things, might be less complex, might be more complex, in terms of use of current-day equipment? What do you think needs to be added?

Mr. TOBIAS. What I hope happens and what we have been pushing to happen is that the Internal Revenue Service changes the concept of training or specific skills delivery to, I guess what a lot of companies have adopted and incorporated into their culture, and that is a learning culture in the Internal Revenue Service, where people have access, particularly through interactive computer learning, to skills development based on need.

So if I look at this job over here, and there are 10 elements to this job, I need skills in eight, I have in two, I can get the eight modules that I need. If I look over here, I'm doing this job, but I look over here, and I might like to do this job in the future, that I could have access to the skills development so that I would make myself eligible to get this job over here.

Now, I think that's the direction that the Internal Revenue Service is planning on taking. It will be a very different place for employees to be, in that kind of environment, than an environment where you walk in, and your first 2 weeks on the job, or 3 weeks, or whatever it is, you get training, and then you're never heard from again. I mean, that's not a place where people get challenged and their best intellect is called on and constantly refreshed. We all need that.

So I'm hopeful that we have a learning environment as opposed to a mere transfer of skills, which is the current situation.

Mr. HORN. Well, that's an excellent response. To what degree do you see sufficient career ladders within the IRS that give people some hope that, if I'm in this job now, I can do just what you have suggested, either be over here or over there, and here's what I need to do to reach that goal? Are there career ladders that would take a person from the bottom of the agency right up?

Mr. TOBIAS. The answer is sort of yes. When I say "sort of yes," what I mean by that is that, for example, if you're a tax examiner, you can be a 3, 4, 5, 6, 7. If you're a revenue officer, you can be a 5, 7, 9, 11, 12. Your career ladder is 5, 7, 9, then you compete for an 11 and a 12. If you're a revenue agent, you are a 5, 7, 9, 11, compete for a 12 and a 13. There are few 14's that are now available.

But I think it's pretty clear that one of the things that has superficially restricted the development of the skills of Internal Revenue Service employees is the idea that you have to get promoted. In order to get a promotion after you have acquired all these skills, you have to become a manager. Some folks do not want to be a manager.

One of the things that I'm hopeful of is that Congress will favorably consider a package of legislation that is, I think, about to come from the administration, that will allow for reclassification so that the highest skilled people can be the equivalent of the lowest managerial folks, so that those who want to depend on their skills and their skill development can do so without having to become a manager, in order to get a promotion at the top of their career ladders. I'm hopeful that can happen. It would make a significant difference.

Mr. HORN. Well, I completely agree with you. And let me tell you, a package like that would have my strong support, because I feel very strongly—I've come out of education, and I see our greatest mistake is to take a very highly effective, able, communicative teacher, K through 12, or professor in a college or university, and make administrators out of them, and they want to aspire to that simply because it pays more.

Mr. TOBIAS. Exactly.

Mr. HORN. And the fact is, we lose an outstanding teacher and an outstanding professor and have a so-so administrator.

Mr. TOBIAS. Or a subperformer.

Mr. HORN. Yes. Often, to be an able administrator, you do not need to be a nobel prize winner. What you need is to have some skills of personality and listening to people, and so forth. And you ought to get hazard pay for some of that. But you certainly, I think, have put your finger on that.

I would like, Mr. Chairman, for the staff to pursue, with the agency, the degree to which there is any cross fertilization in the upward mobility between those lines you described and the others they might have where people have actually moved from one to the other, to see if any of this works at all under the current circumstances.

Mr. TOBIAS. It does to a limited degree. For example, if someone is an accounting aide, they can, with additional schooling and specialty in taking courses in the tax code, they can become tax auditors and then become revenue agents. So someone who starts at a 4, 5, 6, maybe, can become a 13 over time.

But the problem is that there isn't the environment in the agency which encourages this kind of opportunity. I'm hopeful, with this redeployment, it will be a totally different atmosphere, where people will indeed be encouraged to go from one line to another.

Mr. HORN. Now, as head of the union, have you been involved with the management of the agency as to the amount of resources really needed to accomplish this retraining effort? Are you satisfied with what they are asking for? Do you think it's a realistic package?

Mr. TOBIAS. I think that the \$405 million is critical to the success of the retraining effort. Without the \$405 million, it won't happen. It will not happen.

Mr. HORN. What assurances have the employees received that these resources will be forthcoming? Is it simply, we are the guys and gals up here?

Mr. TOBIAS. It's in your hands.

Mr. HORN. In our hands.

Mr. TOBIAS. It's in your hands.

Mr. HORN. So they are saying, "We are with you. It's the other end of the avenue you need to talk to."

Mr. TOBIAS. It's down here. It's on the Hill.

Mr. HORN. Yes. OK. Well, I would hope we would have the vision to support retraining efforts. This is a key agency, and we should not be shortchanging you or, in the case of Justice, the Immigration and Naturalization Service, and the other enforcement agencies so vital to this country's success.

Mr. TOBIAS. Thank you. I appreciate that.

Mr. SPRATT. Thank you, Mr. Horn.

Mr. Tobias, thank you very much for coming here today. Your testimony was very helpful, not just in terms of adding to the record, but also in terms of examining the IRS about the effectiveness. Thank you very much.

Mr. TOBIAS. Thank you very much.

Mr. SPRATT. The subcommittee is adjourned.

[Whereupon, at 12:35 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]



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